United States Air Force Financial Statements 2001

Fiscal Year 2001 Air Force Annual Financial Statements

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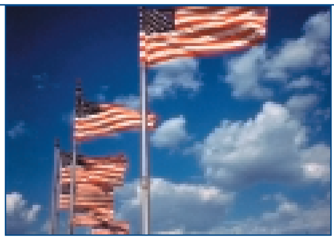


SECRETARY OF THE AIR FORCE
WASHINGTON

February 2002

Message from the Secretary of the Air Force

Fiscal Year 2001 was a challenging year for the United States Air Force. We answered our nation's call to patrol the skies of Iraq and the Balkans and responded to the terrorist attacks of September 11, 2001, by mobilizing Air Force personnel and deploying long-range strike and humanitarian missions in Afghanistan while defending our homeland. In addition to meeting these operational requirements, we continued our commitment to recruit, retain, and develop highly skilled people and accelerated our transformation into a global reconnaissance and strike force for the 21st century. The Air Force worked hard to make critical investments to improve the capability of our current aging weapon systems, and, at the same time, bring new capabilities to the joint warfighting effort.

Meeting these many challenges required exceptional management and judicious execution of resources. In FY01, the Air Force budget was roughly $93 billion. Consistent with the requirements of the Chief Financial Officers Act, this statement documents the expenditures devoted to our General Funds and Working Capital Fund activities. The statement also briefly reviews selected performance measures established as part of the Government Performance and Results Act.

We made effective use of our budget dollars by remaining a leader in financial reform. In FY01 we made strides in achieving auditable and reliable financial statements. Significant actions have been taken to improve the controls in key feeder systems and in the recording and reviewing of obligations. Additionally, we maintained our commitment to train our financial management workforce to meet the increasing demands to provide decision support analysis and improved financial information to the warfighter.

The Air Force is committed to providing the most capable air and space force to the joint warfighting commanders and meeting the national security challenges of the 21st century. We will continue our faithful stewardship of funds to ensure our dominance as the world's leader in air and space power.

DEPARTMENT OF THE AIR FORCE
WASHINGTON DC

OFFICE OF THE ASSISTANT SECRETARY

February 2002

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

The Air Force is committed to providing timely, accurate and reliable financial information to create strategic value for operational decision-making and maintaining accountability to our stakeholders—the American public. We take our responsibility for stewardship of the public funds seriously and are working hard to improve all aspects of financial management. In the spirit of progress, I am pleased to present the Air Force annual financial statements for fiscal year 2001. These statements fulfill the requirements of the Chief Financial Officers Act and portions of the requirements of the Government Performance and Results Act.

The statement documents how the Air Force invested $92.7 billion of taxpayers' funds in support of our nation's defense. In addition, the document briefly reviews our FY 2001 goals in light of actual performance. The Air Force successfully met its operational commitments in FY 2001, including the initiation and conduct of new missions for homeland air defense and the war against terrorism after the tragic events of September 11, 2001. The additional mission requirements of this war beyond existing worldwide commitments have stretched our resources. However, we are working to maximize our productivity to minimize the additional funds that this war will require. Although we are not a business, we are shifting our paradigm to manage both operational and financial performance like a business.

Our strategic intent is to make financial management an enterprise-wide priority and to redefine the role of finance as an enabler of decisions. To fulfill these increasing responsibilities and to aid warfighters in producing effective and efficient outcomes, we have made further progress towards the creation of a world-class financial organization this fiscal year. We are implementing both revolutionary and evolutionary system corrections to achieve an auditable financial statement. For example, the Air Force continues to make progress in linking our key transaction-based feeder systems to the general accounting systems. Yet, much work remains to be done to reach our goal of an enterprise-wide, end-to-end accounting system. We are also reengineering internal processes while balancing the cost of internal controls with their potential for reducing financial fraud. Finally, we have made measurable progress in improving the professional development, training, and certification of our key financial management personnel.

Overall, I am proud to report that your Air Force is building a foundation of sound financial management and control and accountability to drive down costs to promote its proven reputation as the most dominant air and space power in the world.

MICHAEL MONTELONGO
Assistant Secretary of the Air Force
(Financial Management and Comptroller)

Overview

Air Force in Action

In 2001, the United States Air Force (USAF) accelerated its transformation into an unmatched global reconnaissance and strike force responsive to the nation's need, while still meeting the current operational requirements of its joint warfighting commanders.

From precise, long-range strikes and humanitarian relief efforts in Afghanistan, to continuing surveillance over Iraq and the Balkans, to integral and timely contributions to homeland security, the Air Force is answering the nation's call for action.

America's Airmen steadfastly served as part of the team to safeguard the enduring freedom of its citizens. Fiscal year (FY) 2001 witnessed the Air Force's most important asset—its people—standing vigilant across the globe, whether they were building tomorrow's integrated reconnaissance capabilities and strike systems, serving as the focal point for national security in space, or maintaining a robust and capable strategic deterrent.

Overview

Air Force Organizations

The Air Force has molded and transformed into a peerless air and space power, a vital component of joint operations. Despite a decade of decreasing manpower and increasing operational deployments, the Air Force has emerged as a multi-capable, flexible, and decisive instrument of national power. This success is directly attributable to outstanding people: they remain the Air Force's highest priority. Accordingly, they represent the most vital Air Force resource, over and above weapons systems, infrastructure, and similar fundamentals. Air Force personnel provide not only a sense of continuity but also a steady hand as the Air Force transitions to increasingly sophisticated technical systems.

Underpinning the high caliber of the Air Force members are the bedrock values of the U.S. Air Force. These core values reflect the proud Air Force heritage; transcend generations of our members; and provide a lineage as the Service transforms, evolves, and adapts into the 21st century. Indeed, the USAF has always been on the leading edge of technological transformation, due in large measure to the surpassing skills and unequaled commitment of service to country by Air Force personnel.

Detailed information on Air Force personnel and other Air Force resources is included in subsequent performance-related sections.

Major Commands, Direct Reporting Units, and Field Operating Agencies

Major Commands

The Air Force is organizationally aligned into constituent groups starting with major commands. A major command (MAJCOM) represents a subdivision of the Air Force assigned one or more elements of the Air Force mission and is subordinate to Headquarters USAF (HQ USAF). Operational and Support commands reflect the two types of MAJCOMs. The Air Force Major Commands, along with their respective strengths, are listed here.

Direct Reporting Units

Direct Reporting Units (DRUs) report directly to the Headquarters Air Force, owing to singular mission responsibilities. They may range in size and function from the cadets and personnel at the U.S. Air Force Academy (USAFA) to the cadre at the Air Force Doctrine Center (AFDC).

Field Operating Agencies

Field Operating Agencies (FOAs) execute responsibilities under the organizational aegis of a functional manager at Headquarters Air Force. FOAs include such entities as the Air Force Legal Services and Air Force Audit Agency, and accomplish their missions separate from major commands.

Major Command	Total Command Personnel
Air Combat Command	102,000
Air Education and Training Command	81,751
Air Force Materiel Command	82,102
Air Mobility Command	99,303
Air Force Space Command	25,303
Air Force Reserve Command	78,870
Air Force Special Operations Command	9,432
U.S. Air Forces in Europe	34,971
Pacific Air Forces	45,166
*Air National Guard	110,014

*Air National Guard is part of the Air Force Reserve Component and not considered a MAJCOM.

Overview

Fiscal Year 2001 Results

The Fiscal Year (FY) 2001 budget increased nearly ten percent from FY 2000. The total Air Force budget authority was $92.7 billion. This amount includes operation and maintenance (O&M); procurement (PROC); research, development, test, and evaluation (RDT&E); military personnel (MILPERS); military family housing (MFH); military construction (MILCON); and Base Realignment and Closure (BRAC). These funds do not include revenue received from the working capital fund, other services, DoD agencies, or other Federal agencies.

The trend in increasing budget authority will likely continue in the future because our nation is at war in the fight against terrorism, and the President has remarked that we will probably be at war for quite some time. As a result, providing the necessary resources to warfighters is extremely important to our nation's defense and contributes directly to international efforts to eliminate terrorism. President Bush stated on January 23, 2002, "the United States will not cut corners" when it comes to national defense. The Commander in Chief added, "The tools of modern warfare are effective. They are expensive and in order

"It is a great day to be an airman in today's Air Force, with an incredible sense of purpose and knowledge of our place in history. It is also a great day to be a part of the Air Force family."

—James G. Roche
Secretary of the Air Force

to win this war against terror, they are essential. Whatever it takes, whatever it costs, this patient, this resolved nation will win the first war of the 21st century."

Budget by Appropriation Categories

Six major appropriation categories, along with BRAC and the National Defense Airlift (NDA) fund, comprised the Air Force FY 2001 budget of $92.7 billion. The appropriation categories included:

(1) O&M—pays the salaries and benefits of civilian employees and other day-to-day operating costs (e.g., fuels and spare parts)

(2) Procurement—finances major systems purchases

(3) MILPERS—finances the salary and benefits of uniformed personnel

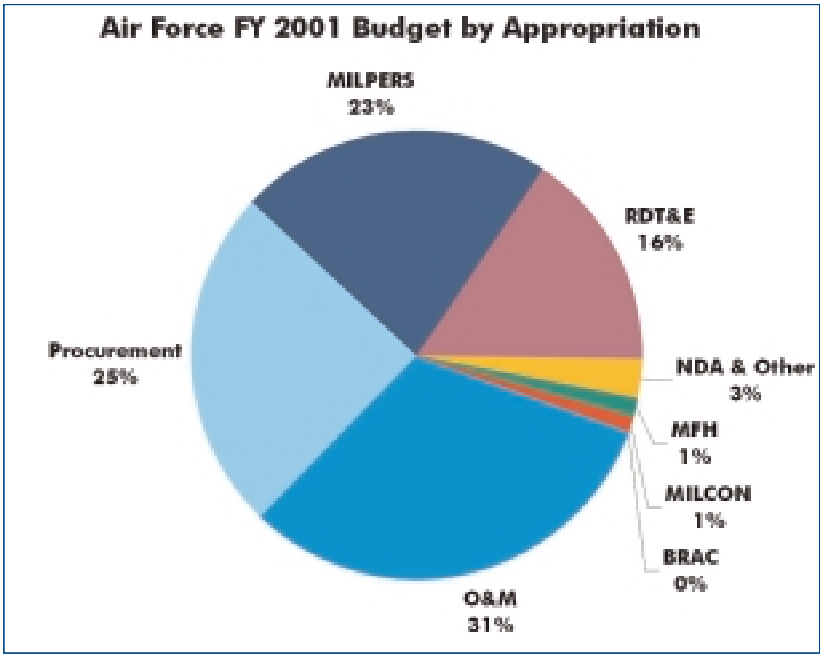
(4) RDT&E—funds system development

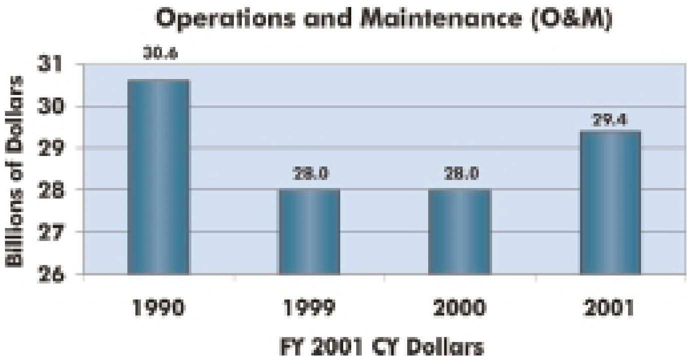
(5) MILCON—pays for facilities construction

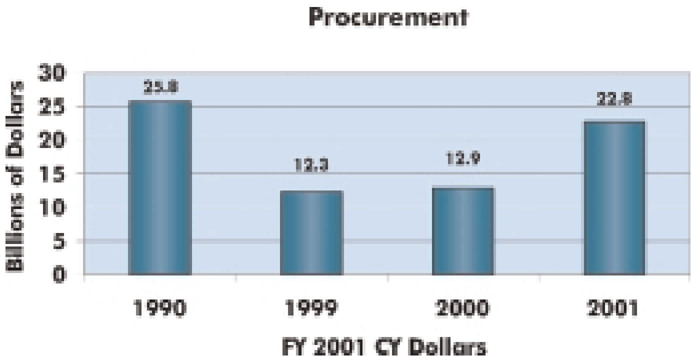
(6) MFH—provides for the operation, maintenance, and construction of housing units

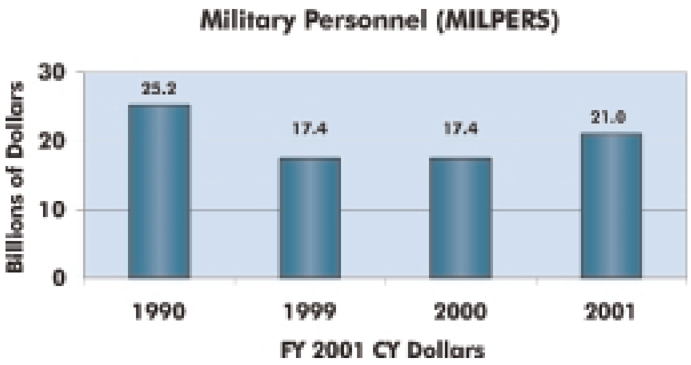
(7) BRAC—congressionally mandated facility cessation funds

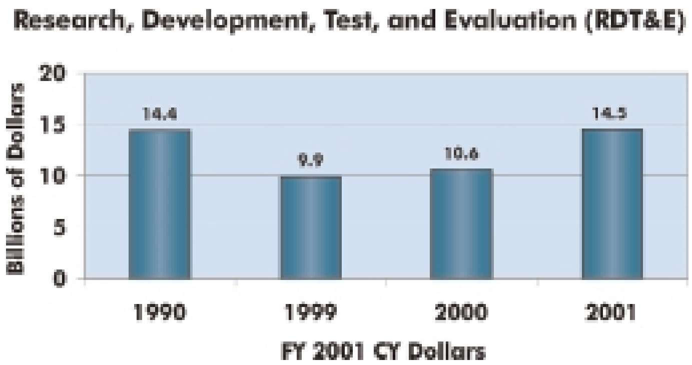
(8) NDA fund—provides for programs, projects, and funds activities appropriate to the C-17 program. In addition, the Other category includes Foreign Military Financing, Environmental Restoration, and Wildlife Conservation on Military Reservations that total less than $3 million in funding.

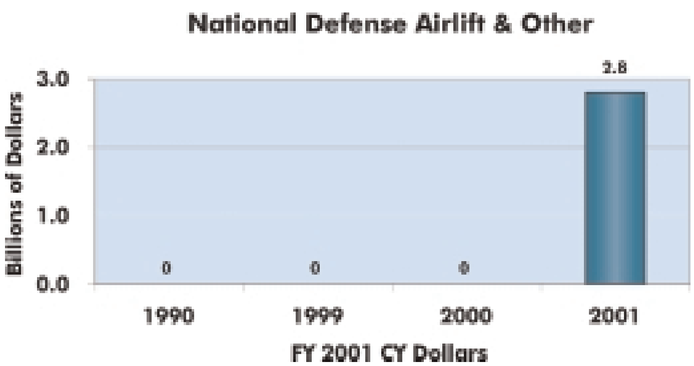


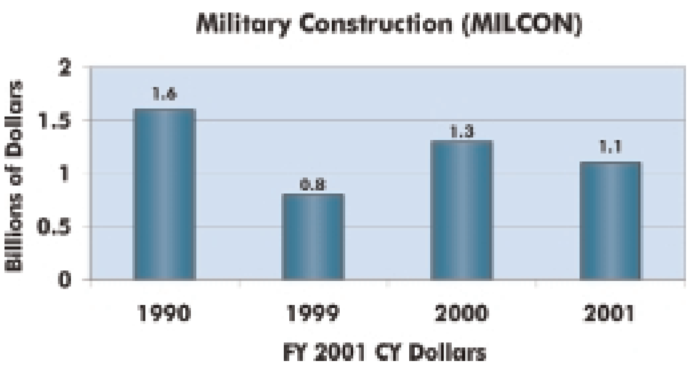


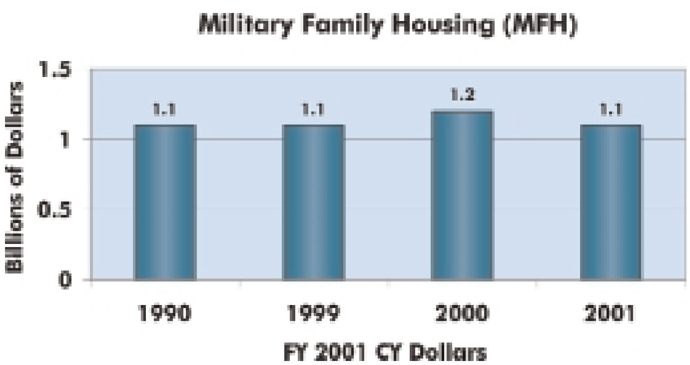


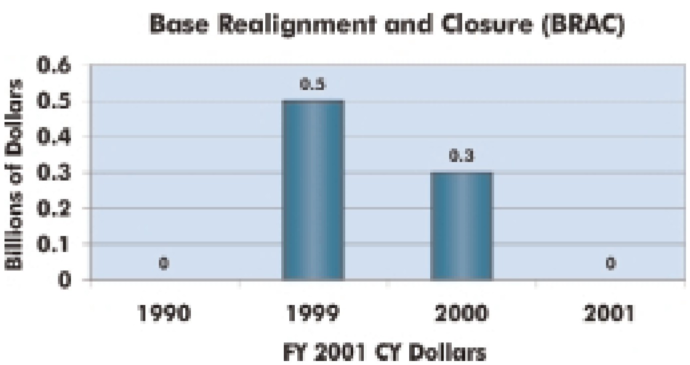

Military Personnel (MILPERS)
Billions of Dollars
30
20
10
0
25.2
17.4
17.4
21.0
1990
1999
2000
2001
FY 2001 CY Dollars


Research, Development, Test, and Evaluation (RDT&E)
Billions of Dollars
20
15
10
5
0
14.4
9.9
10.6
14.5
1990
1999
2000
2001
FY 2001 CY Dollars


National Defense Airlift & Other
Billions of Dollars
3.0
2.0
1.0
0.0
0
0
0
2.8
1990
1999
2000
2001
FY 2001 CY Dollars


Military Construction (MILCON)
Billions of Dollars
2
1.5
1
0.5
0
1.6
0.8
1.3
1.1
1990
1999
2000
2001
FY 2001 CY Dollars


Military Family Housing (MFH)
Billions of Dollars
1.5
1
0.5
0
1.1
1.1
1.2
1.1
1990
1999
2000
2001
FY 2001 CY Dollars


Base Realignment and Closure (BRAC)
Billions of Dollars
0.6
0.5
0.4
0.3
0.2
0.1
0
0
0.5
0.3
0
1990
1999
2000
2001
FY 2001 CY Dollars

Overview

Performance Measures

In FY 2001, the Air Force again chronicled its results under congressionally mandated performance metrics. This section recounts the measurements for each Air Force goal, along with other selected performance measures.

The Government Performance and Results Act (GPRA) of 1993 requires agencies to establish the performance goals necessary to accomplish their respective missions.

Consistent with the goals of the GPRA requirement, the Air Force has historically measured performance according to three overarching goals directly related to mission accomplishment.

Goal 1—Quality People: Ensure a high-quality force of dedicated professionals, and provide an enhanced quality of life and strong sense of community.

"Over the past decade, our nation has demanded increasingly more effort and sacrifice from the Air Force team—our active duty airmen, civil servants, guardsmen, reservists, and contractors—and that team has responded brilliantly."

—James G. Roche
Secretary of the Air Force

Goal 2—Strategy/Operational Performance: Enable joint force commanders to respond to a full spectrum of crises by providing appropriately sized, strategically constituted, ready forces to execute Air Force mission tasks.

Goal 3—Transformation: Prepare for an uncertain future by providing a transformation program that implements the full range of technological advantages and qualitatively superior warfighting capabilities.

Collectively, these goals establish a common organizational direction for USAF subordinate units as they develop their strategic goals, perform essential tasks, and measure their performance.

These Air Force corporate goals link to overall Department of Defense (DoD) goals.

A comparison of FY 2001 actual performance results to target performance (where possible) is consistent with the GPRA.

The First Goal: Quality People

The foundation of the United States Air Force is its people. They are the Air Force's single most crucial readiness component. The people who fight and win America's air wars must be skilled, motivated, and dedicated.

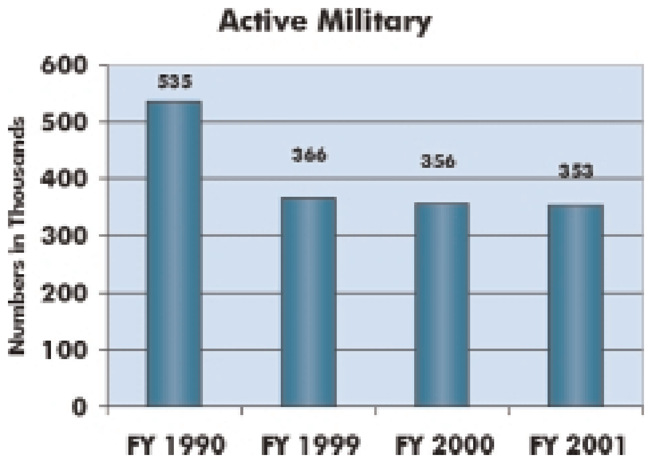
The Air Force relies on a highly skilled, educated, and technologically superior force to function as an effective warfighting team.

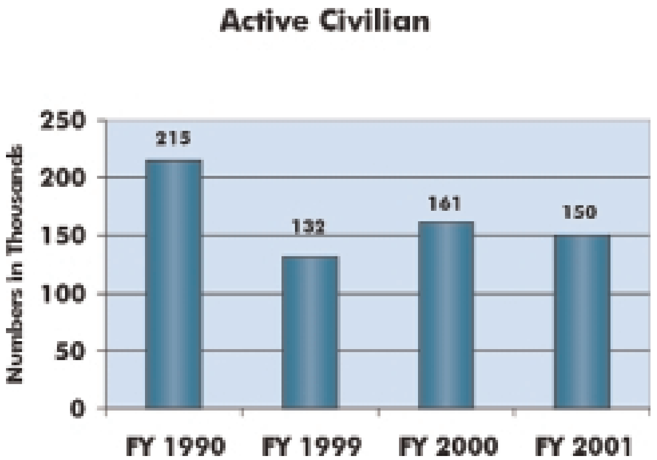
Force structure drawdowns and a mounting demand for U.S. military presence around the globe continues to increase deployed and non-deployed personnel commitments. Still, Air Force members stand proud to serve their country. Senior Air Force leaders value their service and readily undertake the obligation to care for them and their families.

Active Military	Active Civilian
FY 1990—535,000	FY 1990—215,000
FY 1999—366,000	FY 1999—132,000
FY 2000—356,000	FY 2000—161,000
FY 2001—353,000	FY 2001—150,000

The Active Military chart shows how much the active military is shrinking. While the reduction in military personnel has leveled off somewhat in the past few years, active military has declined approximately 34 percent from 1990 levels.

The Active Civilian chart shows that civilian population trends in the active Air Force have declined by more than 30 percent since FY 1990. Due to personnel drawdowns of the past decade, new hires have been limited. Moreover, many experienced employees have moved on to other jobs or have taken advantage of early retirement options. As a result, 42 percent of Air Force civilian personnel will be eligible to retire in the next five years. The Air Force is taking the necessary steps to reshape the civilian force to ensure future availability of sufficient and experienced personnel with the requisite skills to fill the positions.





In addition to the dramatic decline in the military force since the end of the Cold War, the other most significant occurrence has been the shift of people and mission tasking from the active force to the reserve component. The reserve component consists of the Air Force Reserve Command and the Air National Guard. These personnel are not just "add-ons" to the active force, but an integral part of the team—nearly half of the mission-oriented squadrons in the total Air Force are in the reserve components. The vital role reserve forces play today is underscored by the fact that a clear majority of the Air Force's total air refueling capability is in the Air National Guard and the Air Force Reserve.

In concert with the proper emphasis on personnel, the USAF ranks quality of life (QoL) as one of its top priorities. USAF QoL initiatives acknowledge the intense demands placed on the mission-focused total force. The Air Force will, with the continued support of Congress, pursue adequate manpower; improve workplace environments; seek fair and competitive compensation and benefits; balance deployments and exercise schedules; provide safe, affordable, and adequate housing; enhance community and family programs; improve educational opportunities; and provide quality health care.

Continued efforts to compensate the mission-focused total force progressed significantly when the President signed the FY 2001 National Defense Authorization Act (NDAA). As a result, key legislation directly impacting total force pay and compensation, travel and transportation entitlements, retirement, survivor benefit programs, education programs, and healthcare was authorized and implemented over this past year.

"Each Airman, officer or enlisted, is the key to our future."

—James G. Roche
Secretary of the Air Force

Recruiting

As FY 2001 ended, the Air Force was slightly short of its total force goal because retention remains down. The Air Force exceeded its FY 2001 recruiting goal of 34,600, sending 35,381 people to basic training. Further, the Air Force enters FY 2002 with the strongest Delayed Entry Program bank in recent years. About half of the FY 2002 accession needs are already under contract and scheduled to enter active duty during the next year.

The Air Force exceeded its FY 2001 recruiting goal, not by lowering standards, but by intensifying efforts to promote the benefits of the Air Force. This success, in the face of stiff competition from the private sector and an increased propensity to pursue college opportunities, is the result of hard work and new approaches.

Correspondingly, the Air Force Reserve surpassed its FY 2001 recruiting goal of 10,037 by accessing 10,516—105 percent of the goal.

Such success reflects a combination of measures—more recruiters on the street, a focused television advertising campaign, and higher enlistment bonuses. These are all important to manning the force, and the Air Force will continue to make recruiting a top priority.

In support of its recruiting mission, the Air Force:

- Increased the number of production recruiters from 1,085 at the beginning of FY 1999 to 1,465 by the end of FY 2001
- Instituted an aggressive advertising campaign to include a full year of national television advertising
- Kept pace in cyberspace, modernizing the innovative and artistically designed USAF web site to promote a better understanding of the Air Force overall, thereby effectively reaching the Internet generation.

The need to recruit qualified and diverse men and women, both military and civilian, to serve in the U.S. Air Force remains as important today as it was when the service was established. A service population reflective of the strengths of a diverse America will provide the necessary new talent required for today's unique challenges. If the Air Force succeeds in propagating its message to young people across the nation, then it is confident in a positive response.

The Air Force hopes to attract more former airmen (as well as soldiers, sailors, and marines) to return to active duty in FY 2002. The service actively recruited these experienced military professionals, returning 1,155 veterans to uniform in FY 2001. In FY 2002, the Air Force hopes to bring more than 2,000 former members into the active duty ranks.

The Air Force achieved 102 percent of its FY 2001 enlisted recruiting goals by accessing 35,000 airmen to active duty against a goal of 34,600. In terms of quality, more than 99 percent of those enlisting are high school graduates.

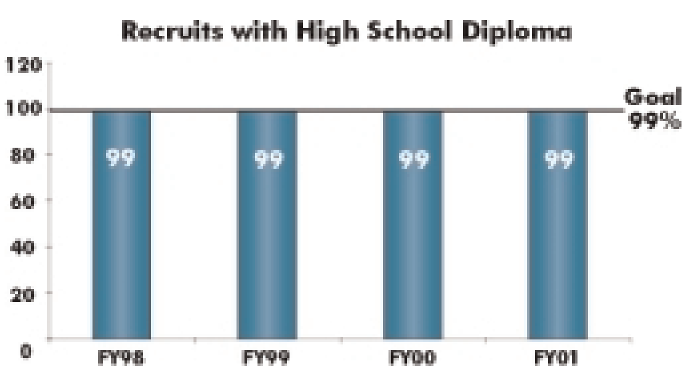
Training

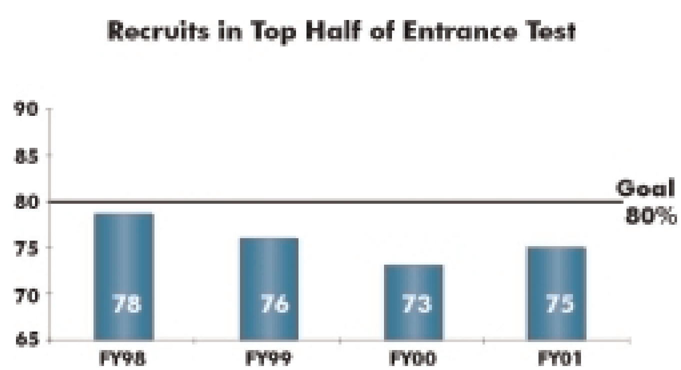
Recruiting good people into the Air Force is just the beginning. They need training to perform highly technical work—the basis of the Air Force's record of military success.

The Air Force continues to offer professional military education (PME) programs that span the careers of both officers and enlisted members. From Airman Leadership School to the Air War College, PME provides opportunities to all Air Force personnel, granting them the skills and knowledge they need to manage Air Force resources and to operate weapons systems.

The newest PME course, the Air and Space Basic Course (ABC) offered at Maxwell Air Force Base, Alabama, is designed to meet the needs of newly commissioned line, non-line, active-duty, Guard and Reserve officers, and selected civilian interns.

Technical training courses are a vital part of the broader training system. For example, the 51-day Security Forces Apprentice course teaches airmen all aspects of their multi-faceted career field missions. The Community College of the Air Force (CCAF) offers numerous courses leading to an associates degree and had awarded more than 216,000 degrees at the close of FY 2001.





Pilot Training

Pilot training is of particular concern to the Air Force, considering the number and quality of trained pilots correlates directly to the ability of the service to accomplish its mission. One useful pilot training measure is the Hours per Crew per Month (HCM) that active duty pilots in Air Force combat-coded units spend flying and training.

Retention

Unfortunately, retention problems offset the benefit of FY 2001's successful recruiting campaign. Although the Air Force exceeded its first-term retention target of 55 percent (achieving 57 percent), it missed the targets set for both second-term and career airman retention.

In FY 2002, the Air Force is initiating a campaign to "re-recruit" the force. Recognizing talented military professionals as an invaluable asset, the Air Force is making a concerted effort to "re-recruit" individuals who have not yet committed to continuing their Air Force career. This effort concentrates on development engineers and pilots, but will expand to other officer and enlisted Air Force speciality codes.

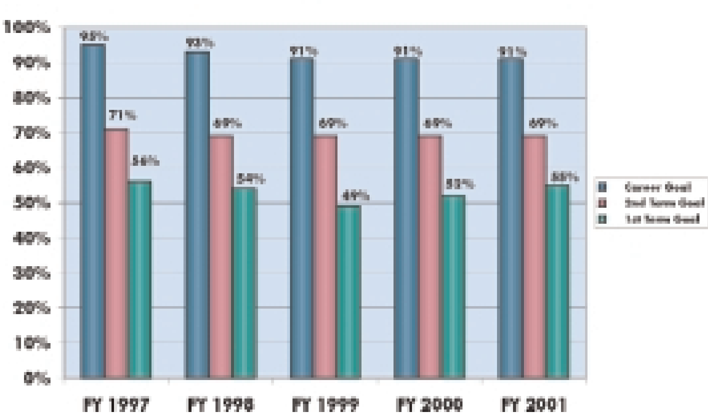
The Air Force Reserve met its end strength goal by reaching 100 percent.

Pilot Retention

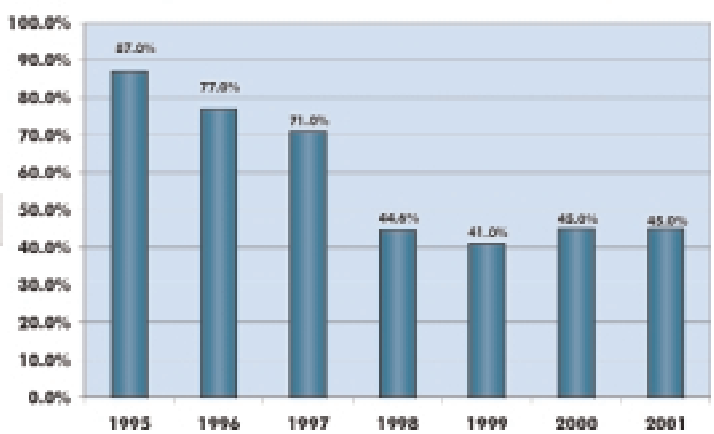
A special subset of the retention challenge is keeping experienced pilots. The U.S. Air Force boasts the world's most efficient and talented support force, combined with technologically superior, integrated air and space systems. However, retention of skilled pilots remains crucial to accomplishing operational missions. Further, at a cost of several million dollars to train and season, a veteran pilot is the Air Force's most expensive personnel asset. A strong economy and unprecedented airline hiring, along with continued high operations tempo, contributed to a shortage of approximately 1,200 pilots, 9 percent of the requirement.

Although the terrorist attacks of September 11 significantly affected airline hiring in the short-term, the long-term effects remain less clear. The Air Force expects the airline industry to fully recover, resuming the pull on the USAF pilot force. As such, pilot retention will continue to be a significant issue for the long-term health of USAF warfighting capability. Therefore, the focus on retention initiatives is long-term rather than short-term. Initiative options include: increasing active duty service commitment, increasing compensation, managing operations tempo, and enhancing quality of life programs.

Enlisted Retention



Pilot Retention—Cumulative Continuation Rates



Programmed Hours Per Crew Per Month (HCM)							
	FY95	FY96	FY97	FY98	FY99	FY00	FY01
Fighter	19.9	20.0	19.3	17.0	17.7	17.2	17.1
Bomber	20.7	19.7	19.9	19.3	17.9	15.9	14.8
Tanker	16.0	15.4	16.2	18.4	17.0	17.1	18.7
Airlift	24.0	24.0	23.8	24.5	23.9	24.0	23.7

Flying Hours Program Execution							
Hours in Millions	FY95	FY96	FY97	FY98	FY99	FY00	FY01
Programmed	1.454	1.327	1.286	1.290	1.324	1.315	1.320
Actual	1.289	1.243	1.179	1.194	1.194	1.273	1.303
% Executed	88.7	93.7	91.7	92.5	90.2	96.8	98.7

Active Air Force HCM is a programmatic indicator that demonstrates the impact of Planning, Programming, and Budgeting actions on combat crew flying hours. As presented, HCM is an aggregate of similar-type aircraft in four combat/combat support groups—fighter, bomber, tanker, and airlift. HCM values vary widely by weapon system and MAJCOM due to mission profiles, crew composition, and training requirements for dissimilar aircraft. Variations over time in each major weapon system's programmed hours relates to changes in missions, training requirements, and average sortie duration (ASD). As a result of significant differences between categories, the HCM aggregate values are not in an overall Air Force composite HCM.

(The hours shown in the Flying Hours Program Execution table are the congressionally funded O&M hours. They do not include incremental contingency hours, Transportation Working Capital Fund hours, foreign national reimbursable hours, Special Operations hours, and RDT&E hours. The flight suspension of the T-3A significantly impacted FY 1998–1999 budget execution. If the congressional program is adjusted to account for this grounding, the execution percentage for FY 1998 and 1999 would have been 96.5 percent and 95 percent, respectively.)

Active Air Force execution of programmed flying hours varies within major weapon systems from year to year for numerous reasons. These include fact-of-life program changes during the year, support to regional contingencies, weapon system retirement, conversion of hours between weapon systems, maintenance issues, and aircraft flight operations suspensions.

The Second Goal: Strategy/Operational Performance

In FY 2001, innovative Air Force strategy devised exceptionally productive use of operational units in the full spectrum of military operations, from deterrence and combat contingency operations to humanitarian aid and disaster assistance. These accomplishments in strategy implementation (e.g., the Expeditionary Air Force (EAF)) were even more striking considering the countervailing factors of constrained resources, aging aircraft, and acute recapitalization needs.

Mission Capable Rates

A measure of aircraft readiness is mission capable (MC) rates. Expressed in percentages, MC rates are the number of times USAF aircraft are ready to perform an assigned mission. By this yardstick, Air Force readiness amounted to 73.5 percent in FY 2001. This reflects the first increase in mission capability since FY 1991.

While the aggregate MC rate stands at 73.5 percent, specific MC rates vary according to aircraft type. The charts on pages 17 and 18 reflect this delineation. Notably:

- Fighter MC rates decreased slightly from FY 2000's rate of 74.3 percent to 73.8 percent in FY 2001, while Bomber MC figures increased significantly, from 65.5 percent in FY 2000 to 70.8 percent in FY 2001.

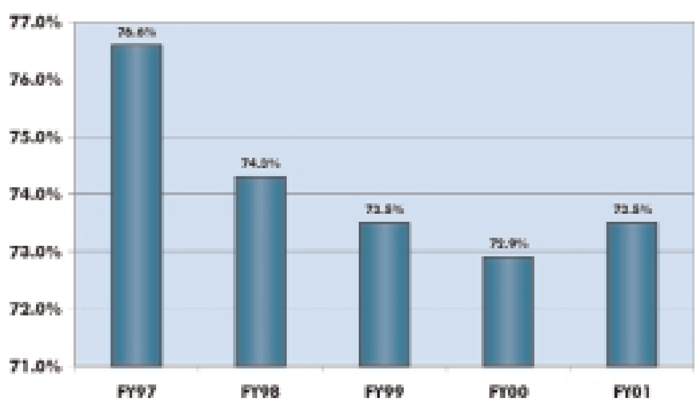
- Strategic Airlift MC improved one percent to 69.1 percent in FY 2001.

- The MC rates for aircraft in the "Other" category also improved, increasing 2.5 percent from FY 2000.

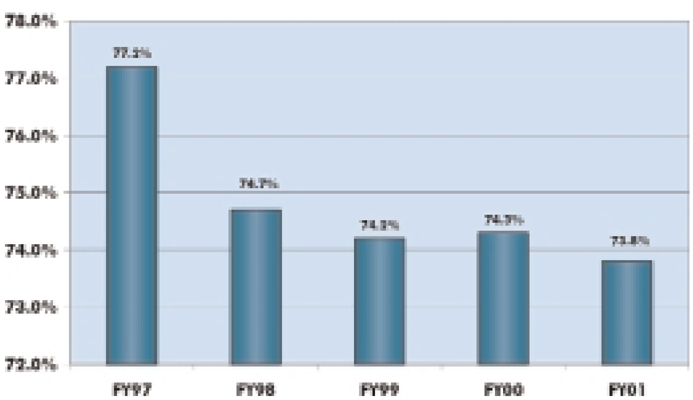
While improved in FY 2001, the MC rates still lag behind desired USAF readiness goals. Several interrelated factors explain this readiness shortcoming and the consequent failure to meet goals. The most prominent factors responsible for lagging MC rates are inconsistent spares funding over the last decade, high operations tempo, maintenance manpower shortages, and most significantly, aging aircraft. Many efforts, including recent spares funding plus-ups and an initiative to robustly fund current and future years spares requirements, are beginning to yield positive results on MC rates.

Efforts by senior Air Force leadership to address other factors also are underway. The Expeditionary Air and Space Force (EAF) initiative, featuring regular deployment schedules, appears to be stabilizing operations tempo and positively impacting retention levels. Recent testimony by the then-Air Force Chief of Staff emphasized the need to recapitalize the force structure to mitigate the effects of aging aircraft and infrastructure. Ensuring operational readiness will continue to receive priority attention at all levels.

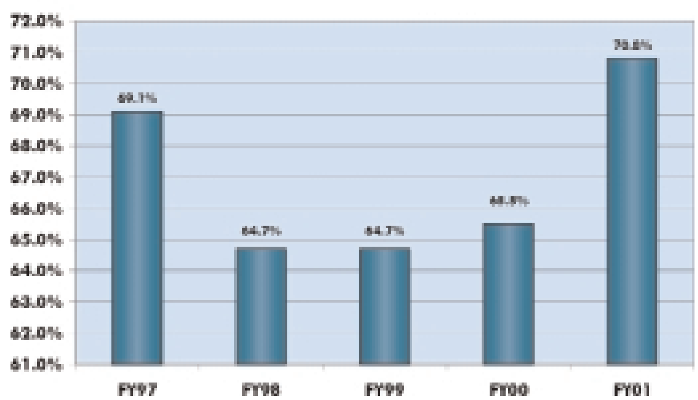
Aggregate Total Air Force – MC Rate

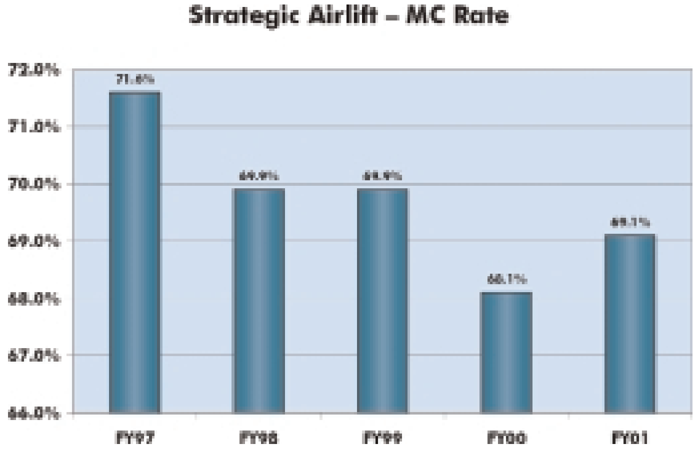


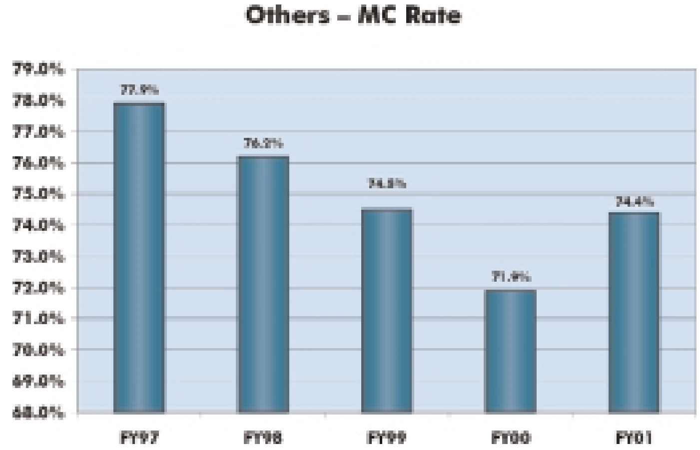
Fighters – MC Rate



Bombers – MC Rate







The Third Goal: Transformation

Transformation represents the linchpin of the recently completed Quadrennial Defense Review (QDR). The Air Force is inherently transformational, as it constantly adapts to new threats and manages new technology to face future challenges.

For the Air Force, transformation means fundamental change that harnesses advanced technologies. These technologies then enable new concepts of operation that can assist in meeting responsibilities and missions the USAF may face. In addition, transformation involves organizational change that better enables the USAF to accomplish its demanding and far-flung missions.

The Air Force believes that the transforming process—and with it, meaningful transformation—can only be achieved through a committed process of change. The Air Force approach to transformation starts with the notion that it cannot achieve meaningful transformation without integrating the service's expanding capabilities with those of the other services and elements of national power.

The USAF views transformation as an activity by which the nation and its military fundamentally change operational concepts, doctrine, organizational structure, training and education, personnel policies, and military technology to expand strategic options and shrink those of adversaries in a rapidly changing environment.

Noteworthy transformation efforts in FY 2001 included a major thrust in the space arena. There, the Air Force began realizing one of the operational goals of the Quadrennial Defense Review—enhancing the capability and survivability of space systems. For the first time, the Air Force integrated a potential adversary's space capabilities into wargaming exercises, ensuring the preparedness of USAF personnel to react to attacks on United States space-related infrastructure. Space systems have now been integrated into virtually every aspect of U.S. military operations and are essential to mission success.

Other transformational efforts include the overarching horizontal integration of Command & Control Intelligence, Surveillance, and Reconnaissance (C2ISR) systems; the provision of vital ISR assets to joint operations in critical regions of the world; and the examination of the potential to transform single-mission platforms into multi-mission platforms.

"There can be no doubt that the quality of our Air Force is directly attributable to the quality of the men and women who volunteer to serve."

—General John P. Jumper
Air Force Chief of Staff

Overview

Financial Management Reform Initiatives

The Assistant Secretary of the Air Force for Financial Management and Comptroller (SAF/FM) strongly supports financial management reform to provide reliable and accurate financial information for Air Force stakeholders. This increased financial information fidelity will enable warfighters to choose more prudently among competing alternatives to produce more efficient and effective outcomes. Through close cooperation with Air Force commanders and managers, the Air Force is making significant progress toward improving financial management and complying with the Chief Financial Officers (CFO) Act of 1990.

As in the past, the Air Force aggressively pursued its goals for financial management reform during FY 2001. The Air Force continues to rely on many government groups, including Air Force Financial Management personnel, the Air Force Audit Agency, the Defense Finance and Accounting Service (DFAS), and other public and private organizations to achieve those goals.

The Air Force needs financial management reform to:

- Provide better financial information to our commanders and managers
- Improve confidence in the Air Force as a good steward of taxpayer dollars
- Meet public law requirements
- Support the President's Management Agenda and the Secretary of Defense's goal for auditable financial statements.

There are many elements to financial management reform success. Among them are improvements in professional qualifications of Air Force financial managers, achieving auditable financial statements, improving compliance with financial rules and regulations, improving cost accounting, driving down the cost of processing transactions, and providing increased decision-support analysis. Efforts have concentrated on improving financial data, financial systems, and professional qualifications, while also increasing compliance, data accuracy, efficiency, and visibility.

Improving Financial Data

The Air Force is striving to achieve auditable financial statements, consistent with CFO Act requirements. The Air Force is focusing on the accounting framework, which includes three accounting areas: budgetary, financial, and managerial cost accounting. After the CFO Act passed, the Air Force focus shifted from budgetary accounting for the expenditure of funds towards accounting for assets and liabilities, much like private businesses. Today, with the requirements for performance-based budgeting and reporting and managerial cost accounting receiving greater attention, the Air Force is conducting pilot experiments with Activity-Based Costing/Management systems to provide better financial information to decision-makers and to identify areas to capture efficiencies.

Improving Budgetary Accounting

Over the past four years, the Air Force has placed significant emphasis on the Budgetary Resources Statement because of its importance in reflecting stewardship responsibilities. This statement and the related disclosures present information on three major elements—funding authorized by Congress, status of those funds, and the total obligated balance at the end of the fiscal year. To date, the Air Force has made considerable progress toward achieving a positive opinion on this statement. Accurately presented on this statement are two of the three major elements. On the final element, composed chiefly of obligation balances, the financial community has taken significant steps to improve the year-end obligated balance by reviewing all obligations tri-annually for accuracy, completeness, and timeliness, and at the same time de-obligating the funds that are no longer required. In addition, the Department of Defense Inspector General, in conjunction with the Air Force Audit Agency, contracted with a Certified Public

Accounting firm to audit the FY 2001 General Fund Budgetary Resources Statement.

Improving Financial Accounting

The Air Force is working hard to improve its financial accounting, which will offer a two-tiered benefit: (1) verify the accuracy of the data used to manage the Air Force and (2) comply with the CFO Act. We are addressing the key deficiencies in reporting assets and liabilities on the Air Force balance sheet through a CFO Integrated Process Team (IPT), headed by a senior financial and logistics manager, to address issues. The IPT uses a coordinated approach, with representatives from all functional communities as well as the Air Force Audit Agency and the DFAS Denver Center. By working together and fully identifying, properly valuing, and correctly accounting for assets, liabilities, and related transactions, the Air Force has resolved significant issues. Examples include environmental costs, computing software development costs, and reclassifying assets.

Improving Managerial Cost Accounting

A primary objective of the financial management community is providing commanders with the best cost information available to aid decision-making. Several key initiatives illustrate progress in this area.

During FY 2001, the Air Force further improved the Air Force Total Ownership Cost (AFTOC) management information system. AFTOC provides detailed information on the costs of supporting weapon systems. The Commanders' Resource Integration System (CRIS) will provide a data warehouse information storage and analysis system, offering a resource analysis tool for flying hour programs. Plans are underway to merge the AFTOC and CRIS databases, resulting in an Air Force Central Cost Data Warehouse.

The Air Force began deployment of the Depot Maintenance Accounting and Production System (DMAPS)/Defense Industrial Financial Management System (DIFMS), which will provide actual data on repair costs for major weapons—a key cost accounting improvement for a business that spends nearly $4 billion per year.

Improving Financial Systems

During the year, DoD established a Project Management Office with the primary goal of documenting the current financial management systems architecture and developing a pro forma plan. Contract awards for assistance in this effort have been initiated with private consulting and accounting firms. The Air Force is closely involved in and supportive of this transformation effort.

While DoD works on developing the overall architecture for financial management systems, the Air Force continues its efforts related to critical "feeder" systems that provide financial data to the accounting systems. The massive effort of upgrading the critical feeder systems to comply with Federal financial management requirements has been underway since 1996, when the Air Force first identified the critical feeder systems. Feeder system managers must ensure that they take

their systems through the steps of awareness, assessment, renovation or replacement, validation, and compliance. At the close of FY 2001, monitoring of 48 feeder systems continues (including eight newly developed systems), and we are tracking progress towards CFO compliance.

Several of our most important systems have made significant progress. Two major systems began the final validation process during FY 2001: the Automated Civil Engineer System-Real Property (ACES-RP) and the Air Force Equipment Management System (AFEMS). Finalized results of these validation audits will be in the second quarter in FY 2002.

One of the largest and most complex of the modifications to feeder systems is a suite of systems supporting the Air Force depots that repair aircraft and other weapon systems. The Depot Maintenance Accounting and Production System (DMAPS) and associated Defense Industrial Fund Management System (DIFMS) will provide much better cost accounting data and comply with the CFO Act. Fielding these systems is currently underway at the three Air Logistics Centers.

Improving Professional Qualifications

The Air Force continues to improve the professional qualifications of its financial management personnel. In May 1999, Air Force financial management leadership issued guidelines for the professional development of its financial managers. These guidelines apply to those in designated positions that are involved in policy decisions or are responsible for enforcing financial laws and regulations. However, the Air Force is encouraging all financial management personnel to follow the guidelines and to complete an Individual Development Plan that exhibits a path to attain the appropriate qualifications.

The guidelines for professional development cover continuing professional education (CPE), general education, professional and military education, experience, and test-based certification. The specific provisions of the guidelines can be found on the SAF/FM web site at: www.saffm.hq.af.mil.

Continuing professional education is a key part of these guidelines because it enables financial managers to stay current in the profession. The guidelines call for those in designated positions to obtain 80 hours of CPE every two years, with at least 20 hours each year. For those Air Force personnel who face difficulty in completing CPE because they work at remote locations and have unpredictable schedules, Air Force financial leaders plan to make CPE easier to complete through distance learning courses, videotapes, articles, and quizzes on the SAF/FM home page, and other techniques. More courses are in development to expand training opportunities.

The guidelines also encourage financial managers to obtain a test-based certification. As part of this effort, the Air Force supports the American Society of Military Comptrollers' test-based certification and training program focused on defense financial matters. Since the certification program's inception in January 2000, 101 Air Force members have received the Certified Defense Financial Manager (CDFM) designation.

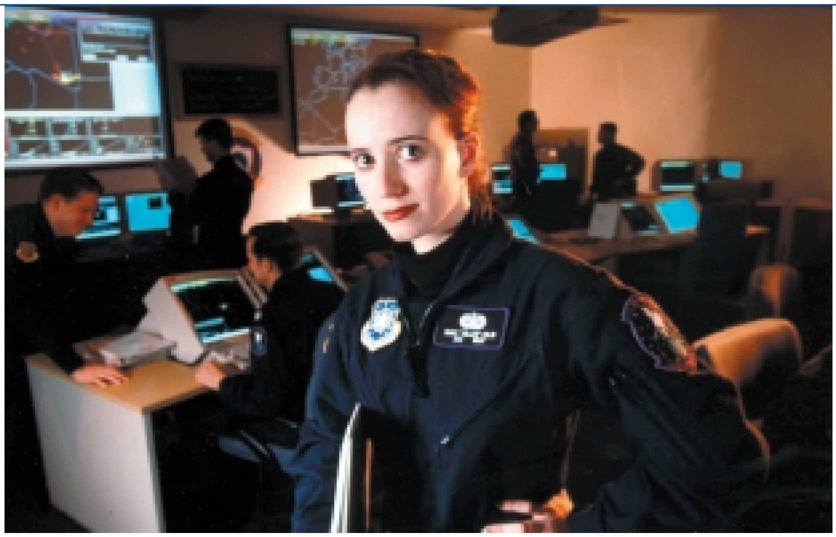
The Air Force is transforming its workforce through a new program called Developing Aerospace Leaders (DAL). The purpose of this program is to determine the skills, knowledge, and abilities related to specific occupations, as well as the universal characteristics necessary to grow an Air Force leader regardless of specific occupation. Once those competencies are defined, the Air Force will develop its officers through targeted training, education, and experience. This development program will include increasing breadth of experience through broadening assignments outside a person's core competencies.

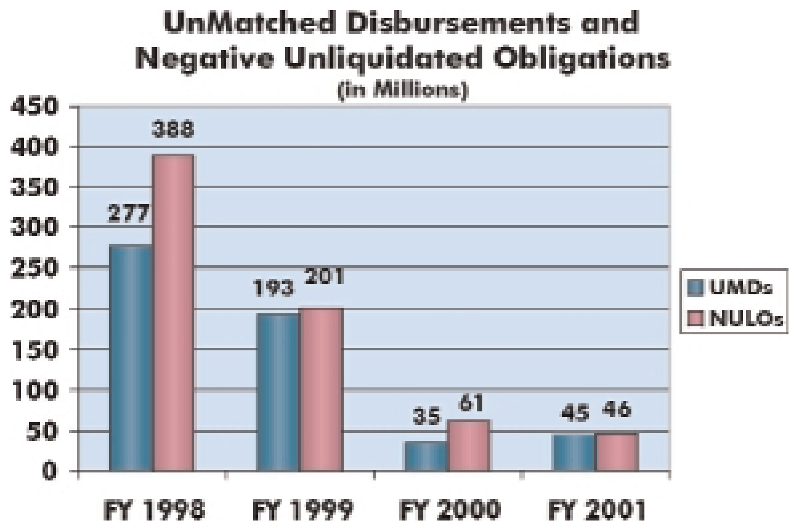
Increase Compliance

A successful financial management environment demands a system of checks and balances to ensure compliance with financial laws and regulations. The Air Force Accounting and Finance Office persists in capitalizing on technological advancements to achieve increased but cost effective financial compliance. Working with financial experts from the field, it reviewed current business practices and identified critical processes for incorporation into a set of standardized self-inspection criteria. These new criteria are available to the entire financial management community through a new web-based Self-Inspection Program (SIP). This program encompasses all facets of Air Force financial operations while ensuring standardization and allowing growth within this ever-changing business environment. The SIP helps ensure compliance and reduce financial fraud.

The Air Force continues to make significant progress in one key area of compliance—the number of reportable Anti-deficiency Act (ADA) violations. The number of reported violations is one indicator of the adequacy of the Air Force's administrative funds control processes. In FY 1999, the Air Force reported only two ADA violations. Although there was an increase to five violations in FY 2000, this number decreased to only three reportable ADA violations in FY 2001.

The Air Force is placing more emphasis on preventive initiatives, including increased fiscal and appropriation law training, along with comprehensive management program and budget reviews. Last year, the Air Force completed a web-based fiscal law course specifically directed at persons with responsibility for ensuring the proper use of appropriated funds. The training focuses on the laws governing the availability and use of Federal funds. This self-administered and certifying training course helps financial managers in establishing, reviewing, and maintaining effective administrative controls over appropriations and funds. Additional improvement in the Air Force anti-deficiency program is attributable to increased support from senior SAF/FM leaders, more attention and involvement from major command financial management organizations identifying and investigating anti-deficiency cases, better screening of suspected violations, and improved anti-deficiency training.





The Air Force also works with DFAS to reduce the overall level of problem disbursements. Problem disbursements are unmatched disbursements (UMDs) plus negative unliquidated obligations (NULOs). A UMD is a financial disbursement not readily matched to a recorded obligation. A NULO is a financial disbursement that appears to exceed the matched obligation. The work done in this area has achieved significant progress (see UnMatched Disbursements (UMD) and Negative Unliquidated Obligations (NULO) chart).

As the charts shows, problem disbursements fell sharply from $665 million in 1998 to $91 million in FY 2001. The Air Force and DFAS continue efforts to reduce the overall level of problem disbursements.

Improve Data Accuracy, Efficiency, and Visibility

The Air Force is using the latest computer technologies to improve the accuracy and efficiency of entering financial information and data. The Air Force also is deploying systems to improve the access and visibility of numerous types of resource information. This visibility increases the potential to spot and fix errors, plus provides better and broader financial analysis. The end goal is to use current technology so that more time is devoted to creating strategic value through financial information and less time is needed to ensure the foundational efforts associated with transaction-based data inputs. Summaries of systems being improved or deployed to help achieve the goal are included here.

Air Force Financial Systems Management Office

The Air Force Financial Systems Management Office (AFFSMO) was created in FY 2001 to provide a single office for program management, oversight, and integration of existing and new Air Force financial systems. Currently, the office is located at Wright-Patterson AFB, Ohio, and oversees the Automated Business Services System, the Commanders' Resource Integration System, the Job Order Cost Accounting System, and the Automated Purchase Card System. The office also explores and tests potential systems such as Wide Area Work Flow and Oracle Financial Systems.

Automated Business Services System (ABSS)

ABSS is now fully deployed to all active-duty, reserve, and guard Air Force locations. ABSS is designed to improve financial efficiency and accuracy in response to the Vice-Presidential mandate to achieve paperless acquisition within DoD. ABSS has met and exceeded this mandate by processing more than 90 percent of the Air Force's acquisition documents in paperless format. This success was achieved because ABSS automates funding documents, such as purchase requests, and electronically feeds the accounting and contracting systems with commitment data. In 2001, ABSS made another "first," by deploying a new version with digital signatures—more technically known as Public Key Infrastructure (PKI) technology. This system improvement allows for increased internal controls, while simultaneously reducing the use of paper documents as an official record. Future improvements include moving ABSS completely to a secure web-based environment, thereby allowing efficient, yet secure, transactions from anywhere at anytime.

LeaveWeb

This simple but effective military leave processing system uses web technologies to increase the accuracy and timeliness of military leave and pay accounting. New system deployment included the Pentagon, Air Mobility Command, Pacific Air Forces, and United States Air Force in Europe, and the system will deploy to remaining Air Force units over the next year. The system allows a military member to go online and fill out a LeaveWeb form using a standard web browser. Like ABSS, entering the pertinent information for a member happens once, and then flows from person-to-person, office-to-office as electronic data. Anyone within the chain of command with proper permission rights may access this information online to approve or deny a leave request, determine leave status, run unit analysis reports, or make administrative changes. At the end of every day, a military pay technician downloads the stored information, digitally certifies the data for accuracy, and then uploads the information to DFAS using the military pay systems. With the use of LeaveWeb, leave accounting accuracy and internal controls have improved dramatically, while customer satisfaction and efficiency have skyrocketed.

Commanders' Resource Integration System (CRIS)

CRIS is a data warehouse information storage and analysis system developed by ACC and now managed by the Air Force Financial Systems Management Office. The system allows financial management and other personnel the ability to perform in-depth resource analysis of accounting, financial, personnel, and logistics information. With this crosscutting and timely information, analysts finally can be "analysts" rather than "data gatherers." The system takes daily data feeds from legacy systems and puts them in a central data warehouse. The data is cleansed and balanced for accuracy, then stored or delivered to its customers for analysis. A customer can access the data warehouse using an online access tool, similar to a Microsoft Excel spreadsheet. Because CRIS gathers data from numerous stovepipe legacy systems, for the first time the analyst has access to the entire procurement, accounting, personnel, and logistics process. This new capability allows the Air Force to correct inaccuracies between systems, substantially reduce the time spent on data collection and analysis, and provide rock-solid financial justifications.

CRIS is currently deployed to all Air Force major commands and will eventually expand to the Air Staff and base-level units in FY 2002. The data warehouse also will expand to include more types of data feeds. The access to total resource data has proved to be another invaluable tool towards achieving CFO Act compliance. With more users and more data, it will become even more useful.

Customer Automation and Reporting Environment (CARE)

CARE is an automated process that provides support for the administration of government and corporate credit card travel and expenses and project purchases through a purchasing card. CARE is a real success story in the Air Force financial management world. Rebates are up dramatically from previous years. Most of the increase is attributable to a faster turnaround time in making payments to the U.S. Bank, or the purchase card issuer. The Air Force began rolling out CARE to the stateside bases in early 2001, and will complete the implementation by Spring 2002. CARE includes additional features that will assist not only the cardholder but also approving officials in managing the program. CARE also allows for account setup and maintenance and contains an automated purchase card log and reconciliation tool. This tool will greatly reduce the amount of time and effort the financial management community expends in obtaining confirmation statements. Additionally, CARE allows charge reallocation to other accounting lines after disbursement, without the preparation of a manual journal voucher to redistribute. CARE processes all the required accounting entries, thereby reducing or eliminating technician reentry errors within DFAS or Financial Service Offices.

Overview

Air Force Future Challenges

In more than 50 years of existence, the United States Air Force has become the world's premier air and space force.

Despite this unrivaled capability, the Air Force unceasingly strives to improve through the process of transformation.

To guide the vital transformation effort, the Air Force is focusing on Strategy, People, Recapitalization, and Efficiencies and Innovation.

The emphasis on strategy involves such innovative constructs as the Expeditionary Air and Space Force (EAF); the horizontal integration of Command and Control, Intelligence, Surveillance, and Reconnaissance (C2ISR) systems; and the emerging Global Strike Task Force (GSTF) concept.

"The American people have the highest confidence in our military forces and are justifiably proud of the Air Force's numerous achievements and bright future."

—James G. Roche
Secretary of the Air Force

General Funds

Air Force personnel are the highest priority for its leaders. The Air Force is committed to comprehensive initiatives in recruiting, "re-recruiting" (retention), and quality of life issues. The Air Force is committed to ensuring these initiatives continue to receive due emphasis.

Recapitalization represents an imposing challenge for the Air Force, but the service is firmly committed to improving air and space capabilities. This entails pursuing necessary investments—key operational assets, modernizing the aging aircraft fleet, and remedying a deteriorating infrastructure. To be sure, the Air Force must recover from a decade-long spending hiatus to provide the tools for its personnel to accomplish its mission.

The U.S. Air Force embraces the critical goal of efficiencies and innovation as it charts its future course. Efficient service practices can free otherwise-wasted resources for vital operational needs and thus increase the effectiveness of USAF air and space capabilities. Air Force innovation is already manifesting itself in acquisition excellence, financial management modernization, a long-range depot strategy, innovative warfighting concept development, and the realization of extraordinary synergy from the implementation of the 2001 Space Commission.

As the Air Force looks to the future, it remains committed to realizing the full potential of organizational changes, new concepts of operations, and next-generation technologies to provide unequaled air and space capability to the joint warfighting commanders.

Overview

Working Capital Fund Concept

"Working capital funds are revolving funds within DoD which finance organizations that are intended to operate like commercial businesses. Income (or budgetary resources) derived from the sale of goods and services are used to finance the defense working capital fund (DWCF) business areas' continuing operations without fiscal year limitations. Unlike profit-oriented commercial businesses, DWCF businesses strive to reach break-even prices charged to customers. Revenue from customers sustains the full cost and the continuous cycle of DWCF business operations.

These business units 'sell' goods or services to internal DoD 'customers' at a price necessary to recover the total cost incurred to provide those goods and services. Working capital fund business units finance their operations with cash from the revolving fund; the revolving fund is then replenished by payments from the business units' customers."

Defense Systems Management College[1]

[1] *Source: DSMC Acquisition Logistics Guide—Life Cycle Costs (LCC) (www.dsmc.dsm.mil/educdept/lmdeptresources/papers/chap13.doc and DSMC Financial Management Terms (www.dsmc.dsm.mil/courses/crsdesc/bcf-103/fmtermstn.doc)*

Overview

Air Force Working Capital Fund (AFWCF)

The Air Force Materiel Command (AFMC) accounts for more than 95 percent of Air Force working capital fund (AFWCF) revenue and expense activity (excluding the transportation working capital fund, managed by the United States Transportation Command). The AFWCF consists of three activity groups—supply management, depot maintenance and information systems. Supply Management supports major Air Force goals and mission-essential tasks by providing inventory management for spare parts and associated logistics support services to fulfill United States Air Force (USAF) 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 specific activities of the Air Force, Department of Defense (DoD), and other Government agencies.

Working capital funds (WCFs) allow the Air Force to:

- Establish strong customer/provider relationships
- Identify the total cost of providing support products and services

- Focus management attention on net results, including costs and performance
- Ensure readiness through reduced support costs, stabilized rates, and customer service.

Funding Authority

The Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) through the Assistant Secretary of the Air Force (Financial Management and Comptroller) (SAF/FM) allocates to activity groups their annual cost authority. Unit cost targets provide standards for managing cost per unit of output, established during the budget process by dividing the projected total program/product cost by the projected units of measurable output. Specific capital investment targets are established to support the replacement and modernization of equipment and other capital assets through the budget, obligation, and procurement processes.

Rates

Established rates are set to recoup full costs with adjustments made for prior year gain or loss. Therefore, during the year of execution there are stabilized rates. The scope of costs paid by AFWCF activities and passed to customers in rates and prices has been refined to represent more accurately the full costs of goods and services.

Mission Impact

The trends reflected in key operational and financial business performance indicators (BPIs) gauge the impact of AFWCF support on Air Force mission capability. These indicators also are the key measure to assess performance under the Government Performance and Results Act (GPRA). Key operational BPIs include the following:

- **Materiel Support Division (MSD) Retail Issue Effectiveness**—The percentage of occasions in which Base Supply is able to issue a serviceable part once an order is placed, regardless of stock level authorizations.
- **MSD Retail Stockage Effectiveness**—The percentage of occasions in which Base Supply is able to issue a serviceable part once an order is placed for items authorized a stock level.
- **Depot Maintenance Activity Group (DMAG) Depot Maintenance Aircraft Delivery Performance**—The percentage of aircraft delivered from depot maintenance on or before negotiated delivery dates.

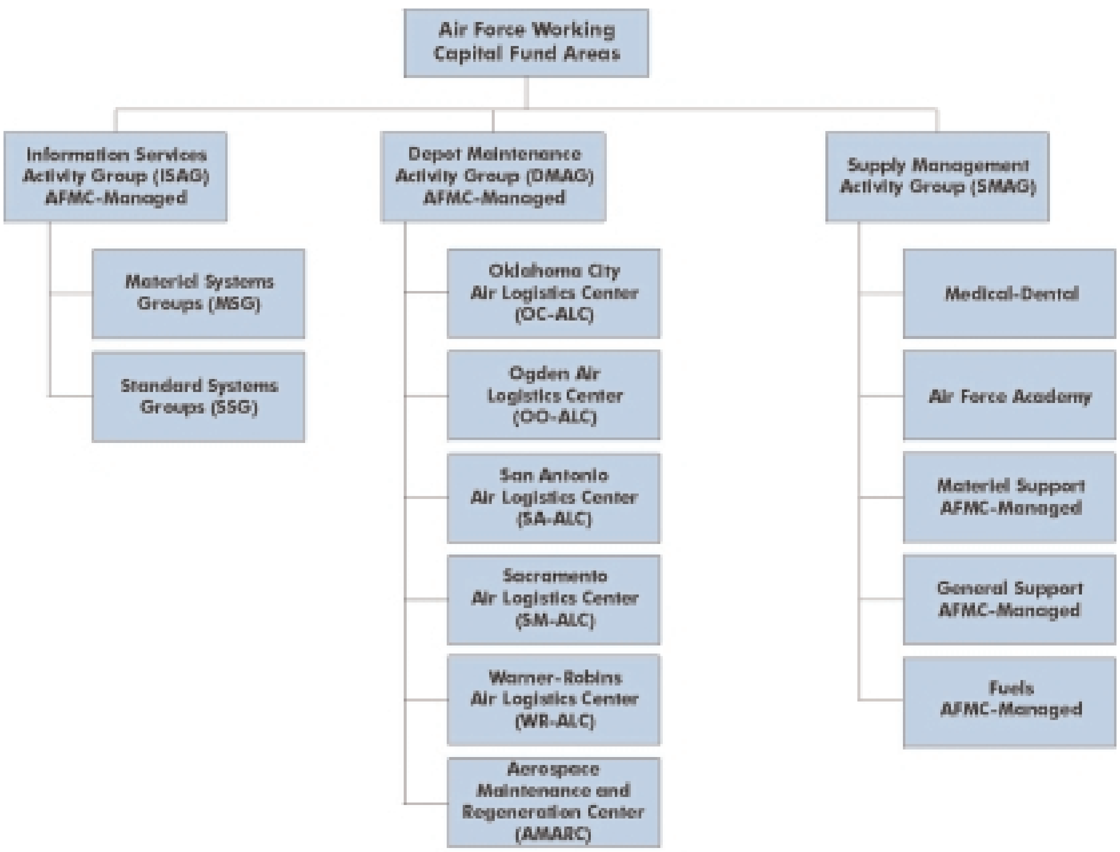
Key financial BPIs measure the effectiveness of AFWCF resource management. Typical measures include:

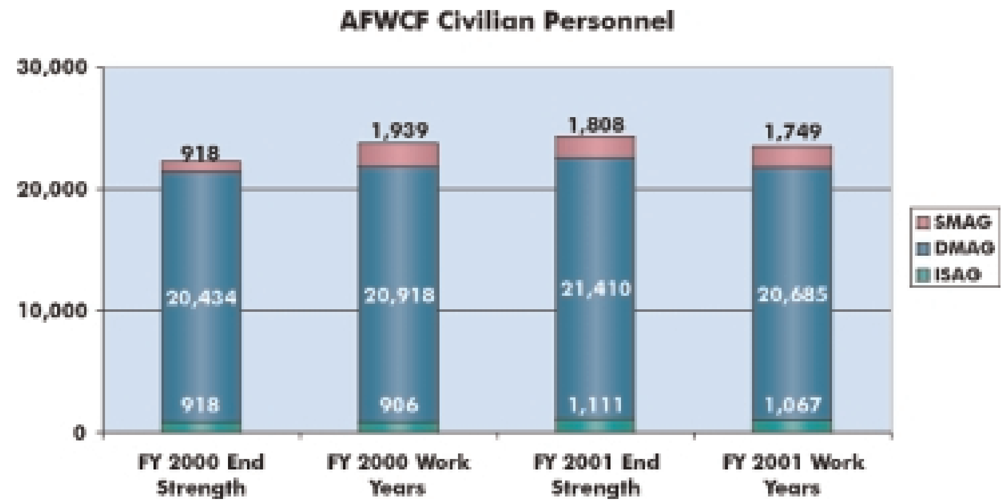
- **Net Operating Results (NOR)**—NOR is calculated by taking the difference between revenue and expenses. It is a bottom-line profit and loss indicator.
- **Unit Cost Target (UCT)**—UCT is a target performance indicator measuring projected resources consumed versus projected output. It is actual unit cost compared against target unit cost.

Overview

Air Force Working Capital Fund Organization

Air Force Working Capital Fund Activity Groups and Divisions




AFWCF Civilian Personnel
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20,000
10,000
0
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20,434
918
1,939
20,918
906
1,808
21,410
1,111
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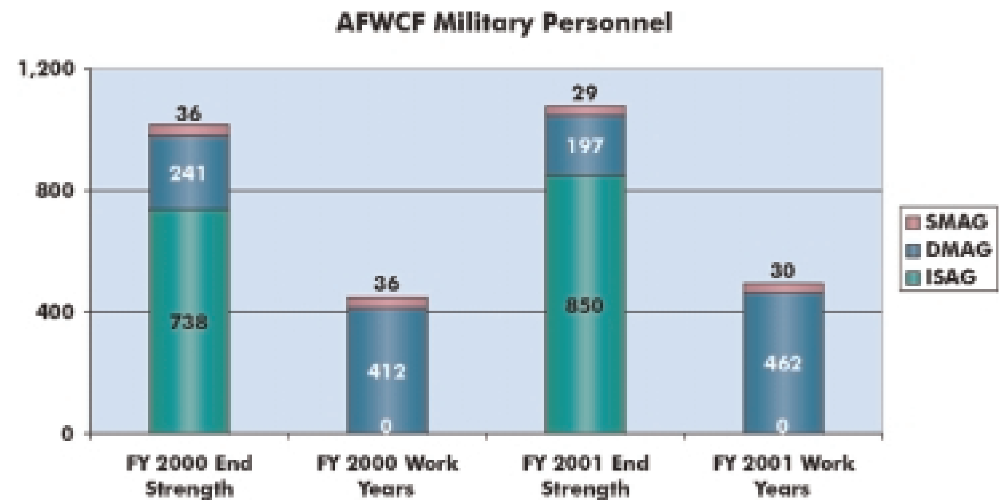
20,685
1,067
SMAG
DMAG
ISAG
FY 2000 End Strength
FY 2000 Work Years
FY 2001 End Strength
FY 2001 Work Years


AFWCF Military Personnel
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241
738
36
412
0
29
197
850
30
462
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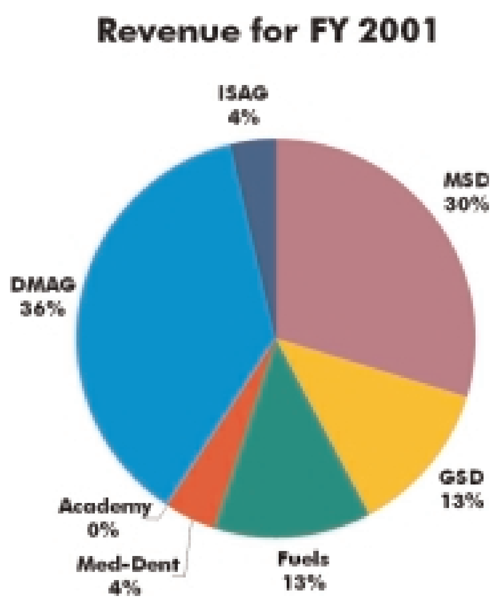
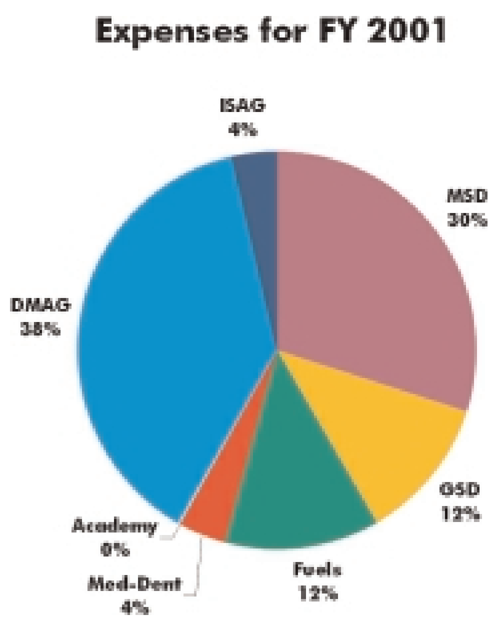
SMAG
DMAG
ISAG
FY 2000 End Strength
FY 2000 Work Years
FY 2001 End Strength
FY 2001 Work Years


Revenue for FY 2001
ISAG 4%
MSD 30%
DMAG 36%
GSD 13%
Academy 0%
Med-Dent 4%
Fuels 13%


Expenses for FY 2001
ISAG 4%
MSD 30%
DMAG 38%
GSD 12%
Academy 0%
Med-Dent 4%
Fuels 12%

Supply Management Activity Group

The Supply Management Activity Group (SMAG) was established to provide inventory management for spare parts and associated logistics support services to fulfill USAF needs during peacetime and wartime. SMAG acquires and repairs inventory items using funds received from prior sales. The activity group pays operating costs using revenue from sales.

Mission Statement

The mission of SMAG is to provide policy, guidance, and resources to meet Air Force needs for spare parts during war and peace. 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 five divisions: the Materiel Support Division (MSD), General Support Division (GSD), Fuels Division (FD), Medical/Dental Division, and Air Force Academy Cadet Issue Division. The Air Force Materiel Command (AFMC) manages the MSD and GSD. The United States Air Force Headquarters (HQ USAF) manages the Medical/Dental Division and Air Force Academy Cadet Issue Division. Beginning in FY 2002, Headquarters Defense Logistics Agency/Defense Energy Service Center assumes management of the Fuels Division.

MSD is responsible for Air Force-managed, depot-level reparable spare parts and consumable spares. The principal products of MSD are serviceable spare parts/assemblies unique to Air Force weapon systems. The sale of reparable parts represents about 90 percent of total sales. The remainder represents sales of nonreparable or consumable items within the MSD. Although most consumable items are transferred to the Defense Logistics Agency (DLA) for management, items designated as weapon system-critical remain on the AFMC product list.

GSD items support installation maintenance and administrative functions, field and depot maintenance of aircraft, ground and airborne communication and electronic systems, and other sophisticated systems and equipment. These items also include individual clothing items issued to new recruits; organizational clothing items, such as firemen's protective overgarments; and air crew helmets and chemical warfare protective overgarments. GSD supports more than 150 Air Force installations throughout the world.

Aviation, ground, and missile fuels categories comprise the Fuels Division. The Fuels Division supplies aviation and ground fuels to the Air Force Air National Guard, Air Force Reserve Command, and other Department of Defense and Government agencies; commercial enterprises; foreign governments; and commercial operations. The missile fuels category supports the National Aeronautics and Space Administration (NASA), Air Force space launch programs, and commercial space launch programs, in addition to the customers named above.

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 their dependents. 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 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 parts, the Supply Management Mission Area (SMMA) 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.

SMMA provides support to a variety of customers. In FY 2001, the customer base consisted primarily of the following:

- Air Force Major Commands (MAJCOMS) (47 percent of sales)
- AFMC depot maintenance and contractors (25 percent of sales)
- Air National Guard and Air Force Reserves (12 percent of sales)
- Other military services within the DoD, other agencies within the Federal Government, and foreign military sales (FMS) (16 percent of sales)

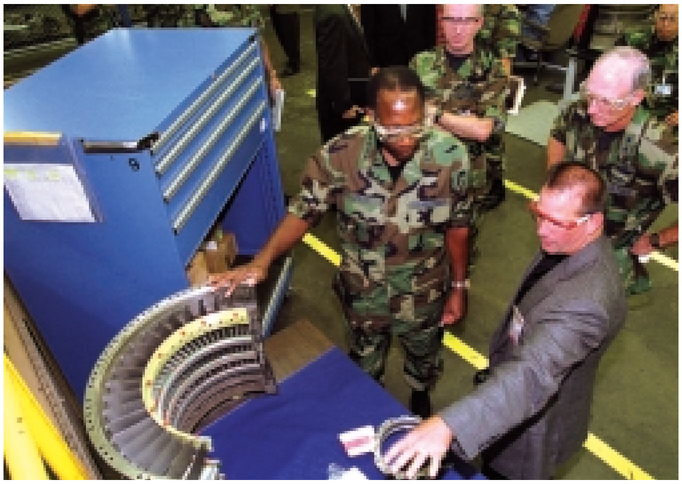
All customers pay for supply services at the same full-cost recovery rate. In addition to providing normal resupply, the supply business also provides initial provisioning support to the Air Force Acquisition Executive.

Performance Measures

Supply Management Highlights

SMAG saw continued improvements in most of its customer support and financial metrics during FY 2001. The activity group met or exceeded most of its FY 2001 goals in its key business performance indicators (BPIs). Due in large part to SMMA's continued supply chain manager (SCM) initiatives, the Constraints Analysis Programs (CAP), the Contract Repair Process (CRP), and the Depot Repair Enhancement Program (DREP), SMAG continued to improve its support to the warfighter.

The SCM mission area initiatives aim at integrating key business processes that support the flow of products, information, and money to improve the efficiency of the supply pipeline. They also seek to identify and resolve constraints. This year the SMMA initiated a Workload Planning (WP) study at Warner Robins ALC. The WP team used two forecasting tools: Demand Solutions and the Execution and Prioritization of Repair Support System (EXPRESS). The study showed that by proactively inducting and producing a limited number of traditionally high-demand items, greater production efficiencies were realized, resulting in better support to the war fighter. The purpose of the CRP and DREP is to enhance the repair



capability of both organic depot and contract repair facilities by determining the best use of people, parts, and funds to fill demands.

The SMMA continued to see improvement for its customer support performance indicators in FY 2001. Since FY 1998, SMMA has witnessed steady improvement in Issue and Stockage Effectiveness, Logistics Response Times, and Backorder Reduction Efforts. While the FY 2001 results were improvements over FY 2000, the SMMA fell short of reaching the challenging FY 2001 targets set by its SCMs in May 2000. The FY 2001 highlights include:

Backorders—The SMMA's impressive backorder reduction trend continued. The number of MSD units backordered was reduced from 263,026 to 252,012 in FY 2001. However, this was short of the FY 2001 goal of 238,000 units. Backorder reduction was well on its way to meeting the goal, averaging 245,000 units for the last six months of the year, but the events at the close of the year generated many additional backorders as organizations prepared for operations NOBLE EAGLE and ENDURING FREEDOM.

Logistics Response Time (LRT)—The SMMA met its FY 2001 reduction goal, finishing the year at 35.7 days, just under the targeted 36 days. The cumulative average for the year was 36 days. There was considerable fluctuation from month to month, ranging from a high of 42.8 days to a low of 31.8 days. This is not unusual, nor is it necessarily negative as LRT often increases as older backorders are filled.

SCM Tool Development—In FY 2001, SMMA continued to develop and refine its web-based tools to assist the SCMs and their customers in tracking and analyzing performance.

- This year SMMA added the Mission Capable (MICAP) Analysis & Reporting Tool (MART) to its "SCM Toolbox." The MART allows SMMA personnel to stratify MICAP hours and incidents by ALC, SCM, weapon system, MAJCOM, cause code, and condition code as well as identifying those National Stock Numbers (NSNs) with the highest number of MICAP hours. This allows the SCM to identify the major drivers of MICAP hours.

Issue Effectiveness (IE) and Stockage Effectiveness (SE)—While IE improved from FY 2000, increasing from 59 percent to 60 percent, the SMMA fell short of its FY 2001 goal of 63 percent. The SMMA experienced a slight decline in its SE performance, dropping from 70 percent in FY 2000 to 69 percent in FY 2001. These mixed results are the product of a diverse realm of factors that include inexperience in setting the goals, resulting in overly optimistic forecasted results, as well as limiting factors for depot production, including capacity, carcass, and parts shortages.

MICAP Hours—The SMMA began tracking MICAP hours as a metric in FY 2001. During this year, the number of MICAP hours was significantly reduced from 5.1 M to 4.2 M hours.

SCM-based Target Setting—Acknowledging that each SCM manages unique items with particular supply chain issues, problems, and concerns, the AFMC and Logistics Business Board (LBB) tasked each SCM to set their own targets for each of the four operational BPIs tracked by SMAG. In May 2000, each SCM developed their own targets for MSD backorders, LRT, issue effectiveness, and stockage effectiveness. In turn, Air Force Materiel Command (Logistics) (AFMC/LG) used these individual targets to set new Air Logistics Center (ALC) and AFMC strategic targets through FY 2006.

Financial Measures

Financial Success

Collectively, SMAG exceeded its FY 2001 goals for unit cost target (UCT) and net operating result (NOR), with each division meeting its target.

Net Operating Result

The NOR is the difference between revenue and expenses, or a bottom-line profit and loss indicator. The objective of the Supply Management Mission Area is to break even over a two-year budget cycle. This is done by setting rates that offset the prior year net profit or loss. The MSD NOR for FY 2001 was a $193 million gain, $96 million above our budgeted NOR gain of $97 million.

For the General Support Division, the FY 2001 NOR goal was a loss of $62.9 million, to return past profits to the customer, but the actual result was a profit of $22.9 million. The increase in NOR was driven by higher-than-planned adjustments for physical inventory.

Unit Cost Target

UCT is a limitation imposed by the Office of the Under Secretary of Defense (Comptroller) on the annual operating budget (AOB), restricting obligations to a percentage of gross sales. The AOB is the funding document providing the authority to incur costs. The UCT is determined by dividing costs by sales. Another description is the ratio of obligations to gross sales. A definition for costs is an obligation (excluding initial and capital expenses) and credit returns. Theoretically, SMAG should aim for a unit cost target ratio of 1:1, meaning a break-even point where sales equals costs. Programmed and achieved by each MSD Center in FY 2001 is actual UCT of 1.053.

SMAG Financial Business Performance Indicators (BPIs)

Financial BPI Goal	MSD FY 2001 Goal	GSD FY 2001 Goal
Revenue	4,729,000,000	1,800,600,000
Expenses	4,667,000,000	1,863,800,000
Net Operating Result (NOR)	62,000,000	(63,200,000)
Unit Cost Target (UCT)	1.047	1.000

Financial BPI Results	MSD FY 2001 Results	GSD FY 2001 Results
Revenue	$4,740,000,000	$1,760,400,000
Expenses	$4,547,000,000	$1,737,500,000
Net Operating Result (NOR)	$193,000,000	$22,900,000
Unit Cost Target (UCT)	1.053	1.039

Financial BPI FY 2002 Goal	MSD FY 2002 Goal	GSD FY 2002 Goal
Revenue	$5,498,000,000	$1,938,200,000
Expenses	$5,407,000,000	$1,928,500,000
Net Operating Result (NOR)	$91,000,000	$9,700,000
Unit Cost Target (UCT)	0.960	1.000

Goals and Initiatives—Efforts to Improve Financial Management

Inventory Valuation

A predominant driver in the Defense Finance and Accounting Service (DFAS) and Air Force reporting differences involves the valuation of SMAG's extensive inventory. Currently, the Air Force is using Latest Acquisition Cost (LAC) for valuing inventory. A complex adjustment using an approved spreadsheet based on the Office of the Secretary of Defense (OSD) model permits the proper recording of the inventory at historical value on the financial statements. The Air Force has elected to change to the historical method of Moving Average Cost (MAC). The change in method will ensure the inventory value is auditable, and it will provide better management visibility to the SCM. An additional issue the Air Force is addressing is the matching principle for expenses to revenue generated. The Air Force is studying the commercial practice of applying an obsolescence or usage factor over time to match the expense to the expected revenue. Throughout FY 2001, the Air Force addressed the proper application of this concept.

MSD Business Performance Indicators (BPIs)

Customer Support BPI	FY 2001 Goal	FY 2001 Result	FY 2002 Goal
Issue Effectiveness (IE)	63 percent	61 percent	63 percent
Stockage Effectiveness (SE)	72 percent	69 percent	71 percent
Logistics Response Time (LRT)	36 days	36 days	36 days
Backorder Reduction	238,200 units	252,012 units	221,600 units
MICAP	No Goal	4,200,000 Hours	3,900,000 Hours

Depot Maintenance Activity Group

The Depot Maintenance Activity Group (DMAG) was established to provide economical and responsive repair, overhaul, and modification of aircraft, missiles, engines, other major end items, and their associated components.

DMAG provides a wide range of specialized services to the DoD as well as other U.S. and foreign agencies.

Mission Statement

DMAG provides major overhaul and repair of systems and spare parts while striving to meet or exceed required standards for quality, timeliness, and cost. In peacetime, DMAG enhances readiness by efficiently and economically repairing, overhauling, and modifying aircraft, engines, missiles, components, and software to meet customer demands. During wartime or contingencies, repair operations surge and capacity is realigned to support the warfighter's immediate needs.

Both AFMC depots and contract operations perform repairs and overhauls. Customers pay for a depot maintenance repaired item when it is needed. Depot maintenance operates on the funds received through selling its products and services. Less than one percent of the activity group's annual budget comes directly from funds authorized by Congress.

Customers, Products, and Services

Depot maintenance supports a variety of customers. DMAG's single largest customer is the Supply Management Activity Group (SMAG), which generates approximately 44 percent of its total revenue. The components repaired for supply management replenish spare parts to the Air Force supply chain. Approximately 48 percent of depot maintenance revenue comes directly from work performed for the major commands, the Air National Guard (ANG), and Air Force Reserve Command (AFRC). The balance of work comes from other services, Government agencies, and foreign countries.

The overhaul of airframes and engines is driven by a planned timetable or number of cycles. Repairs also are made to individual components routed from the field. Repairs are made to missiles and ground electronic systems through scheduled and unscheduled maintenance. AFMC depots provide extensive software capability for developing or modifying software used in operating weapon systems, as well as diagnostic software. Finally, DMAG provides storage, reclamation, and regeneration for equipment not currently used by the active forces of all military services, at the Aerospace Maintenance and Regeneration Center at Davis-Monthan AFB, Arizona.

Depot Workload Strategy

Depot maintenance is a critical element of USAF's overall warfighting capability. Air Force experience, from Desert Storm through ENDURING FREEDOM, continues to reaffirm that organic depots are essential to Air Force air and space power. The current depot posture has been influenced by the downsizing of our operational force; the reduction of our organic infrastructure; the introduction of new technologies; and recent depot legislative changes. To maintain a ready and controlled source of depot maintenance, the Air Force is preparing a Long Term Depot Maintenance Plan for submission to the Office of the Secretary of Defense (OSD) and Congress in 2002.

The overarching objective of this plan is to ensure that Air Force equipment is safe and ready to operate across the whole range of events, from training to supporting major theater wars (MTW) and small scale contingencies (SSC). Partnering with private industry is a key element of the Air Force plan and provides the best-value approach to supporting the warfighter. Leveraging the best of public and private capabilities ensures the Air Force will continue to provide focused support to the warfighter by taking advantage of what each does best. Partnering is the method by which the Air Force will bring in technologies to support core capability requirements in the future. In addition, the Air Force will be able to efficiently utilize its facilities and provide critical support to the warfighter.

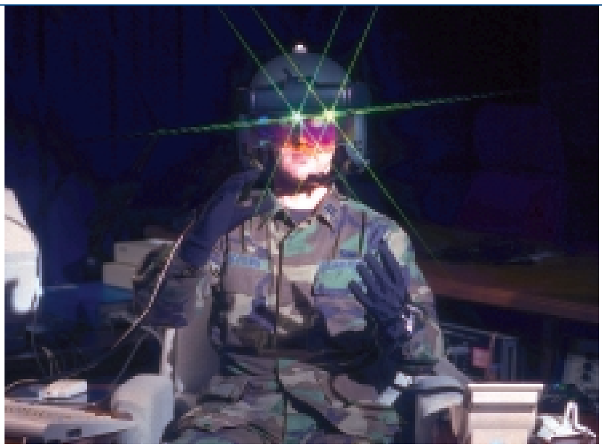
The Air Force Long-Term Depot Maintenance Plan provides military strength by ensuring the possession of an organic "core" capability sized to support all potential military operations. It will be a living document and will posture the USAF's organic depots to continue supporting the warfighter for the next 20 years.

Organization of Depots

Three principal ALCs and the Aerospace Maintenance and Regeneration Center (AMARC) at Davis-Monthan AFB, Arizona, provide DMAG organic services.

Air Force organic depot maintenance sites include:

- Ogden Air Logistics Center (OO-ALC); Ogden, Utah
- Oklahoma City Air Logistics Center (OC-ALC); Oklahoma City, Oklahoma



- Warner Robins Air Logistics Center (WR-ALC); Warner Robins, Georgia
- AMARC; Tucson, Arizona.

Cost Reduction Strategies

The following steps will further reduce the cost of depot maintenance:

- Hiring Industrial Engineering Technicians to review depot maintenance standards and processes. This will ensure accurate costs are used in budgets.
- Hiring Production Management Specialists (PMSs) at the Centers to improve the contract depot maintenance program. This plan compares material financial performance from FY 1998 (the year before additional PMSs were hired) to performance through the current period. Preliminary results show favorable savings initiatives.
- Directly shipping materials from the vendor to the depots, reducing inventory and improving vendor relations.
- Eliminating equipment no longer needed due to workload consolidations, thereby reducing depreciation costs.

Depot Maintenance Manager (DMM)

The goal of the Depot Maintenance Manager (DMM) is to achieve accountability at the lowest level in depot maintenance. The DMM is typically the Product Directorate Chief, who is responsible for the day-to-day management of repair, maintenance, and modifications to weapon systems and materials assigned to a Directorate. This also includes the management of organic production accomplished within the Directorate's Resource Control Centers (RCCs) and directorate-managed contract production.

DMMs must ensure that their portion of the mission area stays within its revenue and expense goals while executing customer requirements. Each DMM is responsible for meeting schedules and quality goals, as well as identifying, tracking, and controlling costs.

Systems Development

Depot Maintenance Accounting and Production System (DMAPS)

AFMC's implementation of DMAPS substantially improves the financial management and reporting of organic Depot Maintenance. It provides AFMC with the capability to capture actual and planned direct material, as well as direct labor at the task level, for daily reporting purposes. It also applies overhead and general and administrative expenses on a planned dollar rate per direct labor hour. This gives managers an opportunity to review production costs at the task level on a daily basis. DMAPS enables AFMC to move closer to Chief Financial Officer (CFO) and Cost Accounting Standards (CAS) compliance. Other benefits include:

- Standard DoD financial reporting system
- Fully automated billing process

- Reduction of legacy systems
- Consolidated fund control process.

DMAPS impacts all organic DMMA employees, especially those in the production, material, financial, and customer order/funding processes at the ALCs. DMAPS also influences the Defense Finance and Accounting Service (DFAS) in Denver, Colorado.

DMAPS is expected to become operational in the third quarter of 2002 at the Ogden ALC. Implementation at Warner Robins and Oklahoma City ALCs is ongoing.

Contract Depot Maintenance Accounting and Production System

CMAPS will monitor all contract actions resulting in the production and shipment of contract end items. The system also will provide data and reports that assist the AFMC sustainment community in managing government furnished material (GFM). A new process within GFM is the establishment of validated Bills of Material (BOM) for each contract end item utilizing GFM. CMAPS will track actual material as well as its cost. The system also will provide visibility of both end items and GFM to the sustainment community.

A new area under development within CMAPS is government furnished equipment (GFE). The system monitors GFE at the Contract Number and Contract Facility level in addition to: National Stock Number (NSN), Part Number, Nomenclature, Serial Number, Acquisition Amount, Date Installed, Depreciation Life, Remaining Depreciation Life, and Accumulated Depreciation.

Workforce

The following objectives are part of AFMC's Workforce Shaping Study to acquire and sustain the human resources necessary to support DMAG. The overall objective is to achieve a trained and flexible workforce, possessing the appropriate mix of skills and expertise to accomplish the command's mission. Details of this command-wide effort are available at https://www.afmc-mil.wpafb.af.mil/HQ-AFMC/DP/2005/, and a summary follows:

- By FY 2002, develop the command human resources management processes required to provide the appropriate quality and quantity of employees to support the command mission.
- Use the processes to assemble and deploy a workforce by FY 2007 to achieve the FY 2009 command objectives.
- By FY 2004, ensure that civilian and military forces obtain the experience, education, and training necessary to support the command mission. Develop and implement programs, policies, and formal career paths designed to encourage career broadening, multi-skill experiences, and functional and managerial training (e.g., Career Program Education and Training Plans, Developing Acquisition Leaders Program).

DMAG Mission Performance Measures

To measure compliance with the DMMA objectives, Business Performance Indicators (BPIs) that assess cost, schedule and quality of DMMA output are used. These BPIs are designed to achieve accountability at the appropriate depot maintenance level, the DMM.

Ten metrics represent the performance effectiveness of DMAG. Four are Financial Effectiveness Measures and six are Performance Effectiveness Measures.

Financial Effectiveness Measures

The DMAG Financial Effectiveness Measures are: (a) Net Operating Result (NOR), which is a computation of revenue minus cost of goods sold; (b) Revenue, which is the income received from customers for goods or services provided by depot maintenance; (c) Cost of Goods Sold, which measures the cost incurred to produce a given quantity and mix of products and/or services; and (d) Expense Rate, which compares planned and actual Cost of Goods Produced.

DMAG Financial Business Performance Indicators (BPIs)

Financial Performance Measures FY 2000 Goal	DMAG FY 2001 Goal	DMAG FY 2001 Result	DMAG FY 2002 Goal
Net Operating Result (NOR)	($14,300,000)	($28,200,000)	$209,868,000
Revenue	$5,626,100,000	$5,633,200,000	$6,214,868,000
Cost of Goods Sold	$5,640,400,000	$5,661,400,000	$6,005,000,000
Organic Expense Rate	146.19	149.71	161.63

Net Operating Result

The Net Operating Result (NOR) is the difference between Revenue and Cost of Goods Sold. In business terms, this is the profit or loss from annual operations. The variance of actual from target NOR is one of the most important indicators of the effectiveness of business operations. The DMAG FY 2001 NOR was a loss of $28.2 million, compared to a planned loss of $14.3 million.

Revenue

Actual revenue for FY 2001 was $7.1 million higher than anticipated, totaling $5,633.2 million versus $5,626.1 million planned.

Cost of Goods Produced

The Cost of Goods Produced measures the costs incurred during the production of a given quantity and mix of products and services. The total cost of goods produced was $21.0 million higher than planned for FY 2001. To support workload transitioning from the closing Centers, contract depot maintenance performed more work and incurred increased costs.

Organic Expense Rate

The total expense rate was 2.4 percent higher than planned. The material expense rate was 0.7 percent over the end-of-year plan. The labor expense rate was 4.4 percent over the end-of-year plan. More overtime and higher than planned production overhead labor drove this variance.

Performance Effectiveness Measures

BPIs assess cost, schedule, and quality of the DMMA output. These BPIs are designed to achieve accountability at the appropriate depot maintenance level, the Depot Maintenance Manager. They measure compliance with DMMA objectives.

The DMAG Performance Effectiveness Measures are:

(a) Organic Production Hours [Direct Product Standard Hours (DPSH)], which depicts how well the DMAG supported its planned production output

(b) Days Held Index (Aircraft), which tracks delivery performance against the initial Aircraft and Missile Maintenance Production/Compression Report (AMREP) date

(c) Aircraft Due Date Performance, which portrays schedule effectiveness

(d) Total Aircraft Quality Defect Rate, which measures the quality of the completed work by the operating unit possessing the aircraft

(e) Engine Quality Rate, which measures the quality of engine production

(f) Exchangeable Quality Defect Rate, which measures the quality of the completed exchangeable by the operating unit.

DMAG Performance Effectiveness Measures

Performance Effectiveness Measures	FY 2001 Goal	FY 2001 Result	FY 2002 Goal
Organic Production Hours (DPSH)	22,478,000	21,723,000	21,838,000
Days Held Index (Aircraft)(yr.)	1.0	1.1	1.0
Aircraft Due Date Performance	90 percent	71 percent	90 percent
Total Aircraft Quality Defect Rate*	0.1 Defects	0.3 Defects	0.1 Defects
Engine Quality Rate	95 percent	98 percent	95 percent
Exchangeable Quality Defect Rate	97 percent	98 percent	97 percent

*Defects per aircraft produced

Organic Production Hours

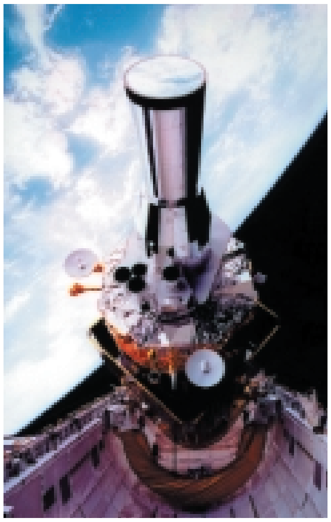
Production hours (planned and actual) are expressed in Direct Product Standard Hours (DPSH) and Direct Product Actual Hours (DPAH). This represents the number of labor hours planned and used in the production effort. Management compares monthly actual DPSHs to monthly planned DPSHs to determine efficiencies. Production Hours are reviewed monthly.

Results for FY 2001

Planned Organic Production Hours were 22,478,000.

Actual Organic Production Hours equaled 21,723,000. Total production hours for the command finished the year below plan by 700,000 hours, or approximately 3 percent under plan. An explanation of the variance is provided by group:

Aircraft commodity group closed out the year 296,000 hours above plan due to a solid recovery. Steady improvements were made on the C and KC-135 production carry-over work. Process improvements that overcame the double wing drop problems resulted in a positive variance for the F-16 aircraft of 94,000 DPSH, or 5.2 percent.



Exchangeable commodities were below plan throughout the year due to lack of parts, lack of an experienced labor force, test station downtime, commodity equipment problems, process qualification issues, and a reduced engine schedule.

Software production was below target by 98,000 hours due to manpower shortages at OC, OO, and WR.

Days Held Index (Aircraft)

The purpose of this metric is to determine the length of time the depot or depot maintenance contractor possesses an aircraft for maintenance or modifications. Total actual flow days divided by total planned flow days yields the index. Acceptable performance is a Days Held Index of less than the Air Force standard of 1.0.

Looking at the Days Held Index for the past 12 months, increases and decreases notwithstanding, the overall trend (variance between planned and actual flow days) throughout the year was above the standard. This difference between the index and standard is consistent with the Aircraft Due Date Performance measure. This measure indicates the effect of delays in aircraft production for both organic and contract.

Aircraft Due Date Performance

Aircraft Due Date Performance measures the ability of the Air Logistics Centers and depot maintenance contractors to produce aircraft according to schedule. This includes all factors, which may not be within their control (e.g. weather, parts, availability of flight crews, engineering evaluations, etc.). The measure tracks organic and contract aircraft by mission design series (MDS) and measures aircraft produced against either the initial or adjusted schedule, but not both. Aircraft produced early and on time, divided by the total aircraft produced equals the Due Date Performance. The thresholds for early, on-time, or late production are: Early—produced more than 5 days prior to scheduled out date; On-time—produced on scheduled out date ± 5 days; and Late—produced more that 5 days after scheduled out date.

Annual production results for FY 2001 were: 1099 total aircraft produced, 778 (71 percent) On Time/Early.

Primary drivers for late aircraft were over and above maintenance related to structural and fuel problems (C-135, C-5), torque deck panels (C-5), and queuing problems due to double wing drops for cracked wing fingers (F-16). In addition, post-dock maintenance, functional check flight problems (both on the ground and in the air), parts, manpower, facility constraints, and fuel problems contributed significantly to delivery problems.

Total Aircraft Quality Defect Rate

The Total Aircraft Quality Defect Rate is an index of the number of defects found by the owning units of an aircraft returned from Programmed Depot Maintenance (PDM). The meaning is expressed as an average of defects per aircraft.

Engine Quality Rate

The Engine Quality Rate measures the ability of the depot to produce engines that are defect-free for use by USAF customers. This measure shows the long-term quality trend of engines delivered to the customer. The standard Engine Quality Rate was achieved 10 out of the previous 18 months. The defect rate trend has remained relatively constant over the past 12 months, a significant achievement considering the turmoil associated with transitioning repair workload to new locations and facilities.

Exchangeable Quality Defect Rate

The Exchangeable Quality Defect Rate measures the ability of the depot, both organic and contract, to produce components that are defect-free and ready for use by the customer. This rate also measures the long-term quality trend of components delivered to the customer. The exchangeable quality rate is determined by dividing total exchangeable defects reported by total exchangeable produced. The defect rate trend has decreased slightly over the past 12 months. In addition, exchangeable production increased during the year.

Goals and Initiatives—Efforts to Improve Financial Management

DMMA objectives flow to the AFMC Strategic Plan. DMMA objectives are expressed as Depot Maintenance Mission Essential Tasks.

Depot Maintenance Mission-Essential Task 1: Provide organic and contract depot repair capability for fielded and emerging weapon systems.

(a) Objective 1: Meet end item delivery commitments 90 percent of the time by the end of FY 2005, commensurate with the adjusted schedule (AMREP date). Exchangeable delivery commitments are based on the flow day metric.

(b) Objective 2: Ensure technically compliant operations across all product lines.

(c) Objective 3: Manage controllable costs (labor and other) to meet or beat the rate of DoD inflation.

(d) Objective 4: Ensure consideration of new and existing weapon systems/technologies during the biennial core assessment to retain a viable organic core capability in the future.

(e) Objective 5: Continue development, implementation, and execution of partnering agreements to support sustainment strategies and to integrate the partnering agreement implementation methodology into the Depot Maintenance Strategy by the end of FY 2002.

(f) Objective 6: Meet or exceed Net Operating Result goals by managing costs each year.

(g) Objective 7: Drive accepted quality defect rates to .03 per exchangeable item, according to individually established

Model Design (MD) and Engine Aircraft Type Model (TM) defect rates.

(h) Objective 8: Improve DMMA budget forecasting, budgeting, and execution processes by forecasting within 1 percent of: (a) total revenue; (b) cost of goods sold; (c) expenses; and 2 percent of direct product standard hours (DPSHs) produced versus center targets. Budget for 100 percent of new customer orders is generated from the Annual Workload Review.

Depot Maintenance Mission-Essential Task 2: Ensure the ability to rapidly respond to user requirements driven by contingency operations.

Objective: Develop short-term and long-term strategies by the end of FY 2002 to implement the depot maintenance strategic plan. Ensure the strategies provide the workload capacity and capability to meet depot maintenance:

(a) peacetime support

(b) surge requirements

(c) core requirements by end of FY 2005.

Information Services Activity Group (ISAG)

The Information Services Activity Group (ISAG) was established to develop and maintain automated information systems for specific Air Force, DoD, and other Government agencies. Central design activities (CDAs) develop and implement new applications, maintain and modify existing programs, provide training and documentation, and customize off-the-shelf software based on customers' specific needs.

Mission Statement

ISAG's mission is to develop, acquire, sustain, integrate, modernize, and secure combat support information systems for USAF and DoD customers.

ISAG provides technological support for all levels of information systems, from the development of leading-edge technologies to the maintenance and modification of older legacy systems. It offers comprehensive support to its customers, including the development, maintenance, integration, and sustainment of their combat support information systems.

ISAG enhances readiness during war and peace by sustaining global combat support information systems, which provide information to combat forces where and when they need it, thus improving the forces' response capability.

Two Air Force activities act as one CDA under the command of the Air Force Materiel Command, Electronic Systems Center (ESC) at Hanscom AFB, Massachusetts. The two activities are the Materiel Systems Group (MSG), located at Wright-Patterson AFB, Ohio, and the Standard Systems Group (SSG), located at Maxwell AFB-Gunter Annex, Alabama.

Customers, Products, and Services

ISAG provides, through the CDA, information products and services via two business lines—the information technology solutions line and the Commercial Information Technology Product Area Directorate (CITPAD).

The information technology solutions business line provides the development and operational sustainment of automated information and communications systems on existing hardware and software platforms for AFMC-level logistics support systems and Air Force base-level standard support systems. This includes a 24-hour, seven-day help desk for field users to call for hardware and software systems support. Additionally, this business line provides automated information and communications systems requirements analysis, system design, development, testing, integration, implementation support, and documentation services on mainframe, mid-tier, and personal computer hardware/software platforms for Air Force and DoD customers using the Software Engineering Institute Capability Maturity Model processes.

The CITPAD business line provides other authorized information system services or products through the acquisition and operation of the CITPAD commodity contracts for the Department of the Air Force and other DoD agencies.

ISAG may furnish these products or services to other agencies and private parties as authorized by law. These authorized services are provided by either organic or contract sources.

The product support business line provides CDA services based on: (1) service-level agreements (SLAs) with known customers and (2) the sale of direct billable hours. However, the CITPAD business line provides goods and services (e.g., personal computers and local area network hardware and services, including installations worldwide) to thousands of individual customers across the Air Force and DoD, making SLAs and the use of direct billable hours impractical.

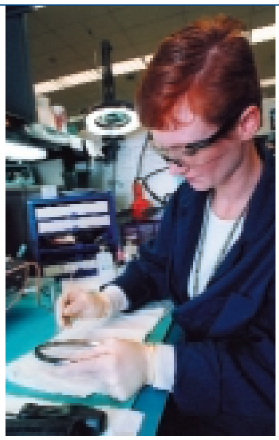
Instead, the CITPAD portion of ISAG contributes to overall organization revenue by collecting a surcharge on orders for equipment and services required by users of contracts or blanket purchase agreements (BPAs).

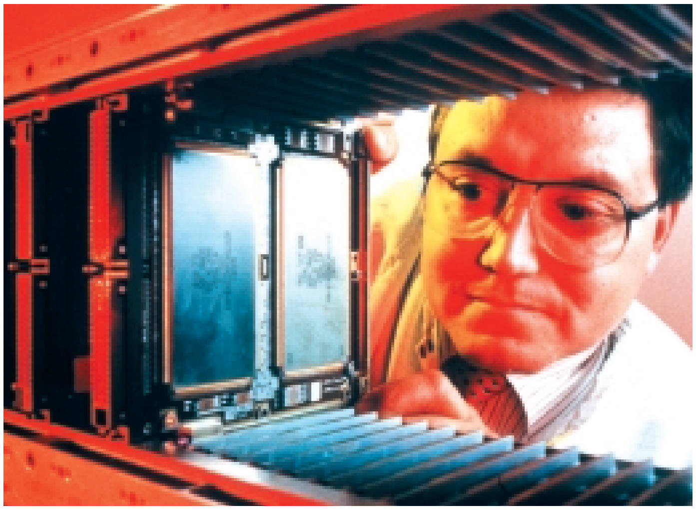
As previously mentioned, ISAG operates in two major locations, each having slightly different market sectors. MSG, headquartered at Wright-Patterson AFB, Ohio, with two operating locations at the Oklahoma City Air Logistics Center (OC-ALC) and the Ogden Air Logistics Center (OO-ALC), has historically concentrated on depot management information systems. SSG, headquartered at Maxwell AFB-Gunter Annex, Alabama, has focused on flight line management information systems.

Performance Measures

Deficiency Reports and Software Releases

Software deficiency reports (DIREPs) are one measure of quality software production. Software releases are software components issued to fix DIREPs and to make minor enhance-





ments as part of sustainment. Priority 1 DIREPs (emergency calls) and priority 2 DIREPs (routine calls) are reported monthly as quantitative measurements. The number of priority 1 and priority 2 DIREPs per 100,000 lines of code are identified, reported monthly, and corrected. Feedback is provided to ISAG developers and customers about the corrective action.

FY 2001 performance is as follows:

- **Software Releases**—98 percent on time
- **Priority 1 Deficiency Reports**—67 percent closed within 48 hours
- **Priority 2 Deficiency Reports**—82 percent closed within 45 days.

AFMC certifies that these performances are all within the acceptable limitations.

Earned Value Management (EVM)

Earned Value Management (EVM) is a management tool that allows customer and software factory/contractor program managers to assess a project's technical, cost, and schedule progress. An EVM system ensures that program managers receive cost and schedule performance data that:

- Relates time-phased budgets to specific contract tasks and/or statements of work
- Indicates work progress
- Properly relates cost, schedule, and technical accomplishment
- Is valid, timely, and auditable
- Supplies managers with information at a practical level of summarization
- Is derived from the same internal EVM systems used by the contractor to manage the contract

Initial implementation of EVM on ISAG software programs began in May 1998. The FY 2001 ISAG cost variance and schedule variance were better than the standard of 13 percent for the entire fiscal year.

Financial Measures

ISAG Financial Performance Measures

Financial Performance Measures	ISAG FY 2001 Goal	ISAG FY 2001 Result	ISAG FY 2002 Goal
Revenue	$588,800,000	$554,200,000	$600,500,000
Cost of Operations	$594,700,000	$561,100,000	$604,000,000
Net Operating Result (NOR)	($5,900,000)	($6,900,000)	($3,500,000)

Net Operating Result

The net operating result (NOR) is a primary indicator of ISAG's financial effectiveness. The computation for NOR is revenue minus cost of operations. For FY 2001, a $5.9 million loss was the NOR target to achieve a zero accumulated operating result (AOR) by FY 2002. ISAG recorded a NOR loss of $6.9 million in FY 2001.

Revenue

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 CITPAD surcharges. Customer funding cuts and new business did not materialize as planned, resulting in a revenue variance of $34.6 million.

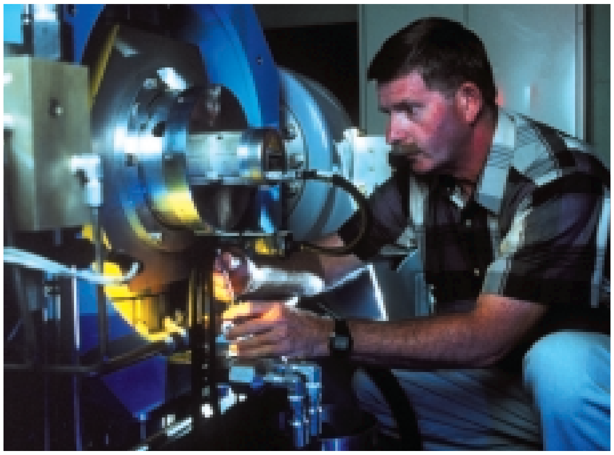
Cost of Operations

For ISAG, cost of operations measures the resources consumed in filling customer orders. These costs include labor and non-labor expenses, both direct and overhead. As stated above, customer funding cuts and program terminations drive the variance in cost of operations ($34.6 million).

Goals and Initiatives—Efforts to Improve Financial Management

CDA will provide mission support services to the Air Force and other customers in a multitude of functional areas, including supply, maintenance, financial management, medical, transportation, munitions, logistics, plans, contracting, and military justice. The goal of the following strategic initiatives is to efficiently and effectively reduce costs and keep the workforce trained to remain competitive through FY 2007. AFMC objectives for the Expeditionary Air and Space Force support weapon systems, cost reductions, work force training, and infrastructure developed in the seven ISAG initiatives:

- Objective 1: Meet or exceed commitments
- Objective 2: Improve customer satisfaction
- Objective 3: Protect information systems
- Objective 4: Meet NOR and AOR targets
- Objective 5: Optimize workforce
- Objective 6: Improve communications
- Objective 7: Properly size capital infrastructure.



Cash Management

The Air Force Working Capital Fund (AFWCF) ended FY 2001 with $918.5 million in cash. The FY 2001 revised, end-of-year budget projection was $326.9 million. The cash increase was largely due to a $500-million-dollar advance billing of DMAG customers in September 2001. The following is a summary of the cash changes:

- The DMAG cash balance increased $190 million in FY 2001. The increase is attributable to the advance billing mentioned above.
- The General Support Division cash balance decreased by $97.4 million in FY 2001. The decrease was the result of purchases exceeding sales and the effect of a negative surcharge.
- The Materiel Support Division cash balance increased $320.2 million in FY 2001. This increase was primarily due to gains in the overhead account, timely collection of receivables, and reduction of repair expense losses.

The DoD cash management policy recommends maintaining the minimum cash balance necessary to meet both operational and disbursement requirements in support of the capital program. Cash generated from operations is the primary means of maintaining adequate cash levels. The ability to generate cash is dependent on setting rates to recover full costs, including prior-year losses, accurately projecting workloads, and meeting established operational goals.

Effective cash management is directly dependent on the availability of accurate and timely data on cash levels and operational results. Cash levels should maintain at least seven to 10 days of operational costs as well as cash adequate to meet six months of capital disbursements. The recommended cash range for FY 2001 was $705 million (seven days) and $977 million (10 days). At the end of the fiscal year, the amount of cash was adequate to meet standards set by the Office of the Secretary of Defense.

Cash management efforts continue to focus on analyzing data and developing tools to identify changes in cash. Although currently available data is outdated for current needs, accuracy has been improving. AFMC completed a statement of sources and uses of cash in FY 2000 and implemented use of the statements to identify areas of cash increases and drains. Work is continuing with regard to identifying and correcting processes that cause cash drains.

Fiscal Year 2001 Air Force Annual Financial Statements

Financial Statements

Limitations of 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.

As of the date these statements were prepared, the Federal Accounting Standards Advisory Board (FASAB) had not determined the final reporting requirements for National Defense Property, Plant and Equipment (ND PP&E). DoD cannot fully comply with existing reporting requirements, because many of the Department's accountability and logistics systems do not contain the cost of the ND PP&E assets. These systems were designed for the purpose of maintaining accountability and meeting other logistics requirements and not for capturing the cost of ND PP&E.

Given the complexity of the existing temporary reporting requirements, the enormous cost of implementing the temporary requirements and the temporary nature, DoD is suspending the reporting of ND PP&E information until such time as the FASAB adopts permanent reporting requirements.

General Funds

Principal Statements

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Consolidated Balance Sheet—General Funds

As of September 30 ($ in Thousands)

		FY 2001		FY 2000
ASSETS *(Note 2)*				
Intragovernmental:				
Fund Balance with Treasury *(Note 3)*	$	44,259,788	$	40,541,322
Investments *(Note 4)*		1,088		1,303
Accounts Receivable *(Note 5)*		394,513		284,642
Other Assets *(Note 6)*		351,706		185,293
Total Intragovernmental Assets	$	45,007,095	$	41,012,560
Cash and Other Monetary Assets *(Note 7)*	$	486,225	$	64,982
Accounts Receivable *(Note 5)*		561,769		506,228
Inventory and Related Property *(Note 9)*		57,610,355		19,269,788
General Property, Plant and Equipment *(Note 10)*		20,444,148		20,536,756
Other Assets *(Note 6)*		5,509,604		4,802,609
TOTAL ASSETS	$	129,619,196	$	86,192,923
LIABILITIES *(Note 11)*				
Intragovernmental:				
Accounts Payable *(Note 12)*	$	740,585	$	997,903
Debt *(Note 13)*		108		109
Other Liabilities *(Note 15 & Note 16)*		2,257,168		1,714,999
Total Intragovernmental Liabilities	$	2,997,861	$	2,713,011
Accounts Payable *(Note 12)*	$	4,180,417	$	4,174,733
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities *(Note 17)*		1,269,811		1,123,249
Environmental Liabilities *(Note 14)*		7,312,942		7,715,253
Other Liabilities *(Note 15 & Note 16)*		4,118,979		3,245,483
TOTAL LIABILITIES	$	19,880,010	$	18,971,729
NET POSITION				
Unexpended Appropriations *(Note 18)*	$	39,006,789	$	35,330,934
Cumulative Results of Operations		70,732,397		31,890,260
TOTAL NET POSITION	$	109,739,186	$	67,221,194
TOTAL LIABILITIES AND NET POSITION	$	129,619,196	$	86,192,923

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

Consolidated Statement of Net Cost—General Funds

For the years ended September 30 ($ in Thousands)

	FY 2001	FY 2000
Program Costs		
Intragovernmental	$ 18,672,472	$ 17,764,148
With the Public	73,807,724	65,236,037
Total Program Costs	$ 92,480,196	$ 83,000,185
(Less: Earned Revenue)	(2,805,964)	(2,959,049)
Net Program Costs	$ 89,674,233	$ 80,041,136
Net Cost of Operations	$ 89,674,233	$ 80,041,136

The accompanying notes are an integral part of the financial statements.
See notes 1 and 19.

Consolidated Statement of Changes in Net Position—General Funds

For the years ended September 30 ($ in Thousands)

	FY 2001	FY 2000
Net Cost of Operations	$ 89,674,233	$ 80,041,135
Financing Sources (other than exchange revenues)		
Appropriations Used	86,135,105	82,974,178
Donations - Nonexchange Revenue	5,872	2,450
Imputed Financing *(Note 20)*	586,864	535,443
Transfers - in	474,001	75,431
Transfers - out	(17,741)	0
Other	2,236,422	0
Total Financing Sources (other than Exchange Revenues)	$ 89,420,523	$ 83,587,502
Net Results of Operations	$ (253,710)	$ 3,546,367
Prior Period Adjustments *(Note 20)*	39,005,325	(5,466,041)
Net Change in Cumulative Results of Operations	$ 38,751,615	$ (1,919,674)
Increase (Decrease) in Unexpended Appropriations	3,766,376	(614,650)
Change in Net Position	$ 42,517,991	$ (2,534,324)
Net Position-Beginning of the Period	67,221,195	69,755,519
Net Position-End of the Period	$ 109,739,186	$ 67,221,195

General Funds Principal Statements

The accompanying notes are an integral part of the financial statements.
See notes 1 and 20.

Combined Statement of Budgetary Resources—General Funds

For the years ended September 30 ($ in Thousands)

		FY 2001		FY 2000
BUDGETARY RESOURCES				
Budget Authority	$	92,717,301	$	83,748,021
Unobligated Balance - Beginning of Period		7,105,052		7,308,408
Net Transfers Prior Year Balance , Actual		(2,130,103)		227,055
Spending Authority from Offsetting Collections		5,211,233		5,053,092
Adjustments		(724,271)		(990,216)
Total Budgetary Resources	$	102,179,212	$	95,346,360
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred	$	94,975,926	$	88,241,307
Unobligated Balances - Available		6,370,402		6,232,287
Unobligated Balances - Not Available		832,884		872,766
Total, Status of Budgetary Resources	$	102,179,212	$	95,346,360
OUTLAYS				
Obligations Incurred	$	94,975,926	$	88,241,307
Less: Spending Authority from Offsetting Collections and Adjustments		(6,483,355)		(6,508,028)
Obligated Balance, Net - Beginning of Period		33,410,761		34,001,921
Less: Obligated Balance, Net - End of Period		(37,049,173)		(33,410,761)
Total Outlays	$	84,854,159	$	82,324,439

The accompanying notes are an integral part of the financial statements.
See notes 1 and 21.

Combined Statement of Financing—General Funds

For the years ended September 30 ($ in Thousands)

		FY 2001		FY 2000
OBLIGATIONS AND NONBUDGETARY RESOURCES:				
Obligations Incurred	$	94,975,926	$	88,241,307
Less: Spending Authority from Offsetting Collections Adjustments		(6,483,355)		(6,508,028)
Financing Imputed for Cost Subsidies		586,864		535,443
Transfers-In (Out)		(17,417)		75,431
Less: Exchange Revenue Not in the Entity's Budget		(2,731)		(406)
Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget		0		(72)
Total Obligations as Adjusted and Nonbudgetary Resources	$	89,059,287	$	82,343,675
RESOURCES THAT DO NOT FUND NET COST OF OPERATIONS:				
Change in Amount of Goods, Services, and Benefits Ordered but not yet Received or Provided (Increases)/Decreases	$	(2,402,847)	$	851,353
Change in Unfilled Customer Orders		23,314		(87,354)
Costs Capitalized on the Balance Sheet - (Increases)/Decreases		(4,569,551)		(8,401,800)
Financing Sources that Fund Costs of Prior Periods		574,535		60,810
Total Resources That Do Not Fund Net Costs of Operations	$	(6,374,549)	$	(7,576,991)
COMPONENTS OF COSTS OF OPERATIONS THAT DO NOT REQUIRE/GENERATE RESOURCES:				
Depreciation and Amortization	$	2,895,300	$	888,923
Bad Debts Related to Uncollectable Non-Credit Reform Receivables		0		1,600
Revaluation of Assets and Liabilities - Increases/(Decreases)		(15,771)		6,953,905
Loss on Disposition of Assets		3,291,006		20,162
Other - (Increases)/Decrease		351,814		(4,601,822)
Total Costs That Do Not Require Resources	$	6,522,349	$	3,262,768
FINANCING SOURCES TO BE PROVIDED	$	467,148	$	2,011,685
NET COST OF OPERATIONS	$	89,674,235	$	80,041,137

The accompanying notes are an integral part of the financial statements.
See notes 1 and 22.

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General Funds

Footnotes to the Principal Statements

Note 1. Significant Accounting Policies

1.A. Basis of Presentation

These financial statements report the financial position and results of operations of the Department of the Air Force as required by the Chief Financial Officers (CFO) Act of 1990, as expanded by the Government Management Reform Act (GMRA) of 1994 and other appropriate legislation. The financial statements were prepared from the books and records of the Air Force in accordance with Department of Defense Financial Management Regulation (DoDFMR) adapted from Office of Management and Budget (OMB) Bulletin No. 01-09, Form and Content of Agency Financial Statements, and to the greatest extent possible, Federal Generally Accepted Accounting Principles (GAAP). The accompanying financial statements account for all resources for which the Air Force is responsible except that information relative to classified assets, programs, and operations has been excluded from the statement 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 used to monitor and control Department of Defense's (DoD's) use of budgetary resources.

The Air Force is unable to implement fully all elements of Federal GAAP and the OMB Bulletin No. 01-09 due to limitations in the financial management processes and systems, including nonfinancial feeder systems and processes. Reported values and information from the Air Force's major asset and liability categories are derived largely from non-financial feeder systems, such as inventory systems and logistic systems. These 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. As a result, the Air Force currently cannot implement every aspect of GAAP and the OMB Bulletin No. 01-09. The Air Force continues to implement process and system improvements addressing the limitation of its financial and non-financial feeder systems.

There are instances where the Air Force has reviewed the intent of the accounting standard and applied it in a manner consistent with the intent of the standard, but auditors interpret the standard differently. Financial statement elements impacted include payments under firm fixed price contracts, operating materials and supplies (OM&S) and disposal liabilities.

A more detailed explanation of these financial statement elements is provided in the applicable footnote.

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

The accompanying financial statements account for resources for which the Air Force is responsible except information relative to classified assets, programs, and operations is excluded from the statements or is aggregated and reported in such a manner that it is no longer classified.

The accounts used to prepare the statements are classified as entity/nonentity. Entity accounts consist of resources the agency has authority to decide how to use or is legally obligated to use to meet entity obligations. Nonentity accounts are assets held by an entity but are not available for use in operations.

The Air Force incorporates into the accounting systems internal controls, reconciliations, management by exception reports, and other management control information.

When possible, the financial statements are presented on the accrual basis of accounting as required by federal accounting standards.

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 * 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	Budget Clearing Accounts
57 * 6XXX (Nonentity)	Deposit Fund Accounts

1.C. Appropriations and Funds

The Air Force's appropriations and funds are divided into general, working capital (revolving), 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. These notes describe attributes of these funds.

General funds are used for financial transactions arising under congressional appropriations, including personnel, operation and maintenance, research and development, procurement, and construction accounts. Air Force working capital fund activities are reported in a separate set of audited financial statements and related footnotes.

Trust funds are used to record receipt and expenditure of funds held in trust by the Government to carry out specific purposes or programs in accordance with the terms of the donor trust agreement or statute.

Special funds account for government receipts earmarked for a specific purpose.

Deposit funds generally are used to (1) hold assets for which the Air Force acts as agent or custodian or whose distribution awaits legal determination or (2) account for unidentified remittances.

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 2001, 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 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 its accounting systems to record transactions based on the United States Government Standard General Ledger (USSGL). Until such time as 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, the Air Force's financial data will be based on budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and adjusted for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities. However, when possible, the financial statements are presented on the accrual basis of accounting as required. One example of information presented on the budgetary basis is the data on the Statement of Net Cost. Much of this information is based on obligations and disbursements and may not always represent all accrued costs.

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 Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," with the need to keep the financial statements from being overly voluminous.

1.E. Revenues and Other Financing Sources

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.

1.F. Recognition of Expenses

For financial reporting purposes, the DoD policy requires the recognition of operating expenses in the period incurred. However, because the Air Force's financial and non-financial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, 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 PP&E or consumed in the case of OM&S. Net increases or decreases in unexpended appropriations are recognized as 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. See note on Intragovernmental Expenses and Revenue for disclosure of adjustment amounts.

1.G. Accounting for Intragovernmental Activities

The Air Force, as an agency of the federal government, interacts with and is dependent upon the financial activities of the federal government as a whole. Therefore, these financial statements do not reflect the results of all financial transactions 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 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 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 Air Force funds a portion of the civilian and military pensions. 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 Statement of Net Cost; and recognizes corresponding imputed financing sources from the civilian employee pensions and other retirement benefits in the Statement of Changes in Net Position.

The DoD reports the assets, funded actuarial liability, and unfunded actuarial liability for the military personnel in the Military Retirement Fund (MRF) financial statements. The DoD recognizes the actuarial liability for the military retirement health benefits in the Other Defense Organization General Fund column of the DoD agency-wide consolidating/combining statements.

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 intragovernment transactions by customer. The Defense Finance and Accounting Service (DFAS) is responsible for eliminating transactions between components or activities of the Air Force. For FYs 1999, 2000 and 2001, 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. Intra-DoD intragovernmental 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 September 2000, the FMS issued the "Federal Intragovernmental Transactions Accounting Policies and Procedures Guide." The DoD was not able to fully implement the policies and procedures in this guide related to reconciling intragovernmental assets, liabilities, revenues and expenses for non-fiduciary transactions. The Air Force however, was able to implement the policies and procedures contained in the "Intragovernmental Fiduciary Transactions Accounting Guide," as updated by the "Federal Intragovernmental Transactions Accounting Policies and Procedures Guide," for reconciling intragovernmental transactions pertaining to investments in federal securities, and 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 provisions of the Act, DoD has authority to sell defense articles and services to foreign countries and international organizations, generally at no profit or loss to the U.S. Government. 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 USACE disbursing stations, as well as the Department of State financial service centers. Each disbursing station prepares monthly reports which 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, by appropriation, on interagency transfers, collections received, and disbursements issued. The Department of Treasury 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 subsequently are reconciled. Differences are provided at note 3. Differences between accounting offices' detail level records and Treasury's FBWT accounts are disclosed in a subsequent note on "Disclosures Related to Problem Disbursements, In-transit Disbursements and Suspense/Budget Clearing Accounts," specifically, differences caused by in-transit disbursements and unmatched disbursements (which are not recorded in the 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 five general fund appropriations (operation and maintenance, 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 used 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. Material disclosures are provided at note 7.

1.K. Accounts Receivable

As presented in the Balance Sheet, accounts receivable include accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts are based upon collection experience by fund type. The Air Force does not recognize an allowance for estimated uncollectible amounts from another federal agency. Material disclosures are provided at note 5.

1.L. Loans Receivable. As Applicable.

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 material & supplies (OM&S). The OM&S are valued at standard purchase price. Ammunition and munitions that are not held for sale are treated as OM&S. For the most part, the DoD is using the consumption method of accounting for OM&S, since OM&S is defined in the SFFAS No.3, "Accounting for Inventory and Related Property" as material, which has not yet been issued to the end user. Once OM&S are issued, the material is expensed. Material disclosures related to inventory and related property are provided in the note on Inventory and Related Property.

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

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

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. The DoD contracted with two certified public accounting (CPA) firms to obtain an independent assessment of the validity of the General PP&E capitalization threshold. At the conclusion of the studies, both CPA firms recommended that the DoD retain its current capitalization threshold of $100,000. All General PP&E, other than land, is depreciated on a straight-line basis. Land is not depreciated.

When it is in the best interest of the government, the Air Force provides to contractors government property necessary to complete contract work. 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, such PP&E is required to be included in the value of General PP&E reported on the Air Force's Balance Sheet. The DoD completed a study that indicates that the value of General PP&E above the DoD capitalization threshold and not older than the DoD Standard Recovery Periods for depreciation, and that is presently in the possession of contractors, is not material to the DoD financial statements. Regardless, 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 property systems.

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

Material disclosures are provided in the note on General PP&E.

1.P. Advances and Prepayments

Payments in advance of the receipt of goods and services are recorded as prepaid and deferred charges at the time of prepayment and reported as an asset on the Balance Sheet. Prepaid charges are expensed 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) and the value equals or exceeds the capitalization threshold, the applicable asset and liability are recorded. The amount recorded is the lesser of the present value of the rental and other lease payments during the lease term, excluding that portion of the payments representing executory costs paid to the lessor, or the asset's fair value. Leases that do not transfer substantially all of the benefits or risks of ownership are classified as operating leases and are expensed as payments are made over the lease term.

1.R. Other Assets

The Air Force conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. In order to alleviate the potential burden on the contractor 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 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 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 address fully or adequately the subject of 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 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 estimated reasonably. 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 will be incurred. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, possible claims and assessments. The Air Force 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 assets. This type of liability has two components: non-environmental and environmental. 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 policies and consistent with SFFAS No. 5, "Accounting for Liabilities of Federal Government", a non-environmental disposal liability is recognized for an asset when management makes a decision to dispose of the asset. Such amounts are developed in conjunction with and not easily identifiable separately from environmental disposal costs. Material disclosures are provided in the notes on Environmental Liabilities and Environmental Disposal Liabilities and Other Liabilities.

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 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 represent the balances that results from subtracting expenses and losses from financing, including appropriations, revenue, and gains since inception of the activities. Beginning in FY 1998, this includes the cumulative amount of donations and transfers of assets in and out without reimbursement.

1.V. Treaties for Use of Foreign Bases

The DoD Components have the use of land, buildings, and other facilities, which are located overseas and have been obtained through various international treaties and agreements negotiated by the Department of State. The DoD capital assets overseas are purchased with appropriated funds; however, title to land and improvements are retained by the host country. 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 which allow for the continued use by the DoD Components. Therefore, in the event treaties or other agreements are terminated whereby use of the foreign bases is no longer allowed, losses will be recorded for the value of any non-retrievable capital assets after negotiations between the U.S. and the host country have been concluded to determine the amount to be paid the U.S. for such capital investments.

1.W. Comparative Data

Beginning in FY 2001, the Air Force presents the current and previous year's financial data for comparative purposes. This data will be presented in the financial statements, as well as in the notes to the principal statements.

1.X. Unexpended Obligations

The Air Force records obligations for goods and services that have been ordered but not yet received. No liability for payment has been established in the financial statements because goods and services have yet to be delivered.

Note 2. Assets

As of September 30,	2001			2000
	Nonentity	Entity	Total	
(Amounts in thousands)				
Intragovernmental Assets:				
Fund Balance with Treasury	$ 8,393	$ 44,251,395	$ 44,259,788	$ 40,541,322
Investments	0	1,088	1,088	1,303
Accounts Receivable	35,362	359,151	394,513	284,642
Other Assets	0	351,706	351,706	185,293
Total Intragovernmental Assets	$ 43,755	$ 44,963,340	$ 45,007,095	$ 41,012,560
Nonfederal Assets:				
Cash and Other Monetary Assets	$ 486,225	$ 0	$ 486,225	$ 64,982
Accounts Receivable	279,502	282,267	561,769	506,228
Inventory & Related Property	0	57,610,355	57,610,355	19,269,788
General Property, Plant and Equipment	0	20,444,148	20,444,148	20,536,756
Other Assets	125,941	5,383,663	5,509,604	4,802,609
Total Nonfederal Assets	$ 891,668	$ 83,720,433	$ 84,612,101	$ 45,180,363
Total Assets:	$ 935,423	$ 128,683,773	$ 129,619,196	$ 86,192,923

Entity assets consist of resources that the Air Force has the authority to use, or where management is legally obligated to use funds to meet its obligations. Nonentity accounts are assets that are held by the Air force, but are not available for use in the operations of the Air Force.

Note 3. Fund Balance with Treasury

As of September 30,	2001	2000
(Amounts in thousands)		
Fund Balances:		
Appropriated Funds	$ 44,245,072	$ 40,514,556
Trust Funds	6,618	2,675
Other Fund Types	8,098	24,091
Total Fund Balances	$ 44,259,788	$ 40,541,322
Fund Balances Per Treasury Versus Agency:		
Fund Balance per Treasury	$ 44,259,786	$ 40,539,373
Fund Balance per Air Force Records	44,259,788	40,541,322
Reconciling Amount	$ (2.00)	$ (1,949.00)

Explanation of Reconciliation Amount

The reconciling amount is due to an error made at Treasury during September 2001 reporting. This amount represents a variance in unrealized discounts in the Air Force Gift Fund. The Air Force records are correct and Treasury records will be corrected in FY 2002.

Other Information

The FBWT in appropriations canceling on September 30, 2001, was withdrawn in accordance with Treasury policy. This amount was $1.7 billion for FY 2001.

The On-Line Paying and Collection (OPAC) differences are reconcilable differences that represent amounts reported by an organization but not reported by its trading partner. As of September 30, 2001 and 2000, there were no OPAC differences greater than 180-days old. A majority of the differences represent internal DoD transactions and, therefore, do not affect the FBWT at the DoD consolidated level. However, for individual entity level statements, these differences would affect the amount reported for FBWT. The DoD is working with the DFAS, and the Department of Treasury to develop an automated tool to reconcile the Treasury's Statement of Differences. The accounting and paying centers established metrics and implemented monthly reporting requirements for FY 2001. These actions aided the Air Force in clearing old balances and establishing better internal controls over the OPAC process.

DFAS is in the process of collecting information for all check issue discrepancy data unsupportable because: (1) records have been lost during deactivation of disbursing offices; (2) the Treasury will not assist in research efforts for transactions over 1-year old; 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 Treasury with a request to remove them from the Treasury Check Comparison Report. The vast majority of the remaining check issue discrepancies are a result of timing differences between the Air Force and Treasury for processing checks. Further, no empirical evidence has been presented that demonstrates check issue discrepancies adversely affect the FBWT.

Note 4. Investments

As of September 30,	2001						2000	
		Cost		Amortized (Premium/ Discount)		Investments, Net		Investments, Net
(Amounts in thousands)								
Intragovernmental Securities:								
Non-Marketable, Market-Based		1,079		(5)		1,074		1,287
Subtotal	$	1,079	$	(5)	$	1,074	$	1,287
Accrued Interest	$	14			$	14	$	16
Total Intragovernmental Securities	$	1,093	$	(5)	$	1,088	$	1,303

See "Investments in U. S. Treasury" section of Note 1 for additional information on investments.

Note 5. Accounts Receivable

As of September 30,	2001						2000	
		Gross Amount Due		Allowance For Estimated Uncollectibles		Accounts Receivable, Net		Accounts Receivable, Net
(Amounts in thousands)								
Intragovernmental Receivables:	$	394,513		N/A	$	394,513	$	284,642
Nonfederal Receivables (From the Public):	$	863,518	$	(301,749)	$	561,769	$	506,228
Total Accounts Receivable:	$	1,258,031	$	(301,749)	$	956,282	$	790,870

Allowance Method

The total allowance is determined at the Air Force departmental level. These department level amounts are derived as follows: For closed years receivables, an arbitrary allowance rate of 50 percent results in an estimated allowance of $292.3 million. Interest allowance of $5.4 million is calculated using an average percent of write-offs to outstanding public accounts receivable over a five-year period. Closed year receivables and interest are payable to the Treasury when collected. For Air Force entity receivables, the allowance is computed each year based on the average percent of write-offs to outstanding public accounts receivable for the last five years and results in an estimated allowance of $4.0 million.

Other Information

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 receivable. Canceled accounts receivables are reported as nonentity receivables because these amounts are deposited into a Treasury miscellaneous receipt account when collected. A reconciliation between Report on Receivables Due from the Public and the Balance Sheet was accomplished. The differences between the Balance Sheet and Report on Receivables Due From the Public (line 7) are $1.1 million and $17.4 million for entity and nonentity receivables, respectively. These differences relate to undistributed collections that are prorated between public and intragovernmental receivables on the balance sheet at fiscal year-end. Also, a $312,000 net difference was due to refunds receivables, reimbursement receivables and posting adjustments between the two reports. Gross interest receivables, nonentity, public was $79.4 million with an allowance for estimated uncollectibles of $5.4 million, resulting in a net of $74.0 million.

Increases in intragovernmental and public receivables for FY 2001 are due to a decrease in public and governmental undistributed collections. Also, a modification to a Deferred Payment Agreement (in litigation) plus interest being charged on these receivables, increased nonentity public receivables.

The amount of public receivables over 180 days is $644.7 million of which $497.5 million represent principal and interest in a deferred payment status. The aging of intragovernmental receivables is currently unavailable.

Accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the Air Force was unable to reconcile intragovernmental accounts receivable balances with its trading partners. The DoD intends to develop long-term systems improvements that will include sufficient controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliation can not be accomplished with the existing or foreseeable resources.

Note 6. Other Assets

As of September 30,	2001	2000
(Amounts in thousands)		
Intragovernmental Other Assets:		
Advances and Prepayment	$ 351,706	$ 100,293
Other Assets	0	85,000
Total Intragovernmental Other Assets	$ 351,706	$ 185,293
Nonfederal Other Assets:		
Outstanding Contract Financing Payments	$ 5,358,278	$ 4,664,816
Other Assets (With the Public)	151,326	137,793
Total Nonfederal Other Assets	$ 5,509,604	$ 4,802,609
Total Other Assets:	$ 5,861,310	$ 4,987,902

The amount of $151.3 million is composed of $125.9 million in advances to contractors and suppliers, and $25.4 million in non-federal advances. Other assets will fluctuate from year to year depending on the timing and/or quantity of advances and recoveries of advances.

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

Note 7. Cash and Other Monetary Assets

As of September 30,	2001	2000
(Amounts in thousands)		
Cash	$ 463,648	$ 56,562
Foreign Currency (non-purchased)	22,577	8,420
Total Cash, Foreign Currency	$ 486,225	$ 64,982

The nonentity assets shown consist of cash reported on disbursing officers' (DO's) SF 1219, Statement of Accountability. The amount of $463.6 million represents undeposited collections of $196.7 million, DO cash of $84.3 million, and deposits from foreign governments to the FMS Trust Fund of $182.6 million. The deposits from foreign governments were not included in FY 2000 and are the cause of much of the increase from FY 2000 to FY 2001.

Note 8. Direct Loan and/or Loan Guarantee Programs

Not applicable.

Note 9. Inventory and Related Property Operating Materials and Supplies, Net

As of September 30,	2001			2000	
	OM&S Amount	Revaluation Allowance	OM&S, Net	OM&S, Net	Valuation Method
(Amounts in thousands)					
OM&S Categories:					
Held for Use	$ 47,343,429	$ 0	$ 47,343,429	$ 19,225,521	SP
Held for Repair	10,223,991	0	10,223,991	0	SP
Excess, Obsolete, and Unserviceable	2,259,752	-2,216,817	42,935	44,267	NRV
Total	$ 59,827,172	$ -2,216,817	$ 57,610,355	$ 19,269,788	

Legend for Valuation Methods:
SP = Standard Price NRV = Net Realizable Value

Other Information

In FY 2001 the DoD proposed a change in the definition of National Defense Property Plant and Equipment (ND PP&E), removing several types of assets from this category. The Air Force elected to reclassify tactical missiles, cruise missiles, aircraft engines, missile motors, and pods as OM&S. This accounting policy change required a prior period adjustment of approximately $37 billion to bring these items onto the balance sheet.

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, however, are not recorded at historical cost in conformance with the valuation requirements in the SFFAS No. 3, "Accounting for Inventory and Related Property". Instead, the Air Force uses standard price to value its inventory without computing any unrealized holding gains or losses. For the most part, the Air Force uses the consumption method of accounting for OM&S (acquisitions and deletions), as defined in SFFAS No. 3, by expensing materials once issued.

The general composition of OM&S held for use includes $16.9 billion in munitions and $30.4 billion in assorted aircraft engines, missile motors and miscellaneous parts. Material held for use includes material held due to operational economies and material held due to managerial determination.

The value of some, but not all, of the Air Force's Government Furnished Material (GFM) and Contractor Acquired Material (CAM) in the hands of contractors is included in the OM&S balances.

Excess, Obsolete, and Unserviceable OM&S are revalued from their standard price to their net realizable value (NRV). Based upon current policies and procedures, the NRV is 1.9 percent of the standard price and the reported value of Excess, Obsolete and Unserviceable OM&S value was reduced $2.2 billion.

In FY 2001, the Air Force contracted with contractors to manage the C-17, C-130J and the F-22 aircraft programs. The value reported for OM&S managed by these contractors amounted to $580.5 million. In addition, nine manually maintained accounts reported inventory balances for this fiscal year. The data from these accounts is not complete as to acquisitions and issues, so the difference between the beginning and ending balance was recorded in Other Gains (unrecognized) which will effect the Statement of Financing and Statement of Net Cost. Additionally, no OM&S financial data pertinent to "Classified" accounts is included.

Note 10. General PP&E, Net

As of September 30,	2001					2000
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
(Amounts in thousands)						
Major Asset Classes:						
Land	N/A	N/A	$ 346,220	N/A	$ 346,220	$ 284,595
Buildings, Structures, and Facilities	S/L	20 Or 40	37,663,517	$ -22,086,205	15,577,312	14,894,813
Software	S/L	2-5 Or 10	29,221	-700	28,521	0
Equipment	S/L	5 Or 10	10,237,108	-8,579,029	1,658,079	2,857,737
Assets Under Capital Lease1	S/L	lease term	387,860	-154,466	233,394	184,790
Construction-in-Progress	N/A	N/A	2,597,485	N/A	2,597,485	2,314,820
Other			3,137	0	3,137	0
Total General PP&E			$ 51,264,548	$ -30,820,400	$ 20,444,148	$ 20,536,755

1 Note 15.B for additional information on Capital Leases

Legend for Valuation Methods:

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

Real Property represents the facilities, infrastructure, and land maintained by the Air Force and is carried at historical cost net of accumulated depreciation. The increase in land values is due to the reporting of land at overseas locations. Also included in the value of real property is real property in the possession of contractors. Assets remaining at base realignment and closure locations are not included in the PP&E amounts reflected on the financial statements. These assets have been considered excess and have no further operational value to the Air Force.

Reporting for internal use software under SFFAS No. 10 is effective for the FY 2001 financial statements. Included in the software assets are software costs of systems that budgeted over $2 million for internal use software. Software costs of new development efforts and those that added significant functionality were capitalized and reported as assets. Software costs for maintenance and modernizations were expensed.

Personal property in the Air Force consists of general equipment, ADP hardware, medical equipment, and special tools and special test equipment. As of September 30, 2001, an estimated $20.8 million of general equipment was not valued at historical cost. To assure that this data was included in the financial statements, the Air Force used the latest acquisition cost for each item and/or estimated the date of acquisition to provide a basis for manually reporting.

The Air Force reported $170.3 million in Special Tools and Special Test Equipment (ST/STE) on the financial statements. Since the date placed in service was not available, the Air Force used the "date aircraft delivered". The cost data could not be validated, but it appears most items are fully depreciated.

The value of personal property does not include all of the personal property in the possession of contractors. The net book value of such property is immaterial in relation to the total General PP&E net book value. In accordance with an approved strategy with the OMB, the GAO and the Department of Defense Inspector General (DoDIG), the DoD is developing new policies and a contractor reporting process to capture personal property information for future reporting purposes in compliance with federal-wide accounting standards.

The $3.1 million reported as other represents the year end estimated timber value on Air Force properties. The value used is based on budgetary amounts to be realized in FY 2002. The value based on timber cutting contracts for FY 2002 and the remaining uncut portions of FY 2001 contracts was not available. In FY 2000 a timber value of $.4 million was reported on another Other Assets line on the Balance Sheet. The FY 2000 value was incomplete, as collections for FY 2002 timber sales were in excess of $2 million.

Note 10.A. Assets Under Capital Lease

As of September 30,	2001	2000
(Amounts in thousands)		
Entity as Lessee, Assets Under Capital Lease:		
Land and Buildings & Equipment	$ 387,860	$ 306,423
Accumulated Amortization	-154,466	-121,633
Total Capital Leases	$ 233,394	$ 184,790

Description of Lease Arrangements

The Air Force is the leasee in twelve capital leases. Eleven are for Military Family Housing acquired through Section 801 Family Housing Program, and one is for a piece of medical equipment. The leased facilities are capitalized and reported as an asset when the cost of the facilities exceeds the capitalization threshold. Facilities not meeting the capitalization threshold are expensed. All leases prior to FY 1992 are funded on a fiscal year basis. This correlates to six of the Military Family Housing Leases.

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30,	2001			2000
	Covered by Budgetary Resources	Not Covered by Budgetary Resources	Total	
(Amounts in thousands)				
Intragovernmental Liabilities:				
Accounts Payable	$ 737,074	$ 3,511	$ 740,585	$ 997,903
Debt	0	108	108	109
Other	1,378,029	879,139	2,257,168	1,714,999
Total Intragovernmental Liabilities	$ 2,115,103	$ 882,758	$ 2,997,861	$ 2,713,011
Nonfederal Liabilities:				
Accounts Payable	$ 4,180,417	$ 0	$ 4,180,417	$ 4,174,733
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	0	1,269,811	1,269,811	1,123,249
Environmental Liabilities	0	7,312,942	7,312,942	7,715,253
Other Liabilities	1,096,092	3,022,887	4,118,979	3,245,483
Total Nonfederal Liabilities	$ 5,276,509	$ 11,605,640	$ 16,882,149	$ 16,258,718
Total Liabilities:	$ 7,391,612	$ 12,488,398	$ 19,880,010	$ 18,971,729

Other Intragovernmental Liabilities Covered by Budgetary Resources consists of $128 million in advances from others, $1.3 million in deposit fund liabilities, $604.5 million in resources payable to treasury, $612 million in DO cash liability, and $32.2 million in civilian benefits liability-government portion. The increase over FY 2000 is due to DO cash liability.

DO Cash Liability includes $182.6 million of deposits of foreign governments to the FMS Trust Fund as referenced in note 7.

Other Intragovernmental Liabilities Not Covered by Budgetary Resources consists of $131.2 million in accounts payable canceled appropriations, $417.3 million in judgement fund liabilities, $299.3 million in FECA reimbursement to DoL, and $31.3 million in military unemployment compensation liabilities. The increase over FY 2000 is due to judgement fund liability.

Other Non-federal Liabilities Covered by Budgetary Resources consists of $994.5 million in accrued payroll and benefits liabilities for military and civilians, $36.0 million in Temporary Early Retirement Authority liabilities, $58.4 million in advances from others, and $7.1 million in deposit fund liabilities. The increase over FY 2000 is due to accrued payroll and benefits liabilities.

Other Non-federal Liabilities Not Covered by Budgetary Resources consists of $80.7 million in accounts payable canceled appropriations, $3.6 million in civilian unemployment compensation liabilities, $93 million in environmental liabilities, $462.1 million in capital lease liabilities, $637.1 million in contingent liabilities, $1,745.6 million in accrued annual leave liabilities for military and civilians, and $.7 million in accrued interest liability. The decrease from FY 2000 is due to contingent liabilities, nonenvironmental disposal liabilities, and accounts payable in canceled appropriations.

Note 12. Accounts Payable

As of September 30,			2000
	Accounts Payable	Total	Total
(Amounts in thousands)			
Intragovernmental Payables:	$ 740,585	$ 740,585	$ 997,903
Nonfederal Payables (to the Public):	$ 4,180,417	$ 4,180,417	$ 4,174,733
Total	$ 4,921,002	$ 4,921,002	$ 5,172,636

For the majority of buyer-side transactions, the Air Force feeder and DFAS accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the Air Force was unable to reconcile intragovernmental accounts payable balances with its trading partners. The DoD intends to develop long-term systems improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliation can not be accomplished with the existing 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. Positive differences were treated as unrecognized accounts payable and in the case of the Air Force, accounts payable were adjusted upwards in the amount of $985.1 million.

Note 13. Debt

As of September 30,	2001			2000
	Beginning Balance	Net Borrowings	Ending Balance	Ending Balance
(Amounts in thousands)				
Agency Debt:				
Debt to Other Federal Agencies	109	(1)	108	109
Classification of Debt:				
Intragovernmental Debt			$ 108	$ 109

The intragovernmental debt consists of interest, penalties, and administrative fees and results from payments made out of the DoD Education Benefits Fund. Payments to Post-Vietnam Era Voluntary and Involuntary Separatees are made in advance of contributions from the services. The DoD Board of Actuaries has determined that the services must pay the accumulated interest on this unfunded liability.

Note 14. Environmental Liabilities and Environmental Disposal Liabilities

As of September 30,	2001			2000
	Current Liability	Noncurrent Liability	Total	Total
Environmental Liabilities:				
Nonfederal:				
Accrued Environmental Restoration (DERP funded) Costs:				
Active Installations—Environmental Restoration (ER)	$ 385,437	$ 4,653,317	$ 5,038,754	$ 4,844,034
Active Installations—ER for Closed Ranges				829,400
Other Accrued Environmental Costs (Non-DERP funds)				
Active Installations—Environmental Corrective Action	0	246,189	246,189	0
Active Installations—Environmental Closure Requirements	0	61,506	61,506	0
Other	0	0	0	175,519
Base Realignment and Closure (BRAC)				
BRAC Installations—Environmental Restoration (ER)	33,400	1,554,106	1,587,506	0
Other	13,291	316,336	329,627	1,863,179
Environmental Disposal for Weapons Systems Programs				
Other National Defense Weapons Systems	0	49,360	49,360	3,121
Total Environmental Liabilities:	$ 432,128	$ 6,880,814	$ 7,312,942	$ 7,715,253

The relatively small change of just over 4% in the Defense Environmental Restoration Program (DERP) restoration liability between September 30, 2000 and September 30, 2001 results largely from the addition of almost 100 new sites that resulted in a $421 million increase in estimated cost. Also, the addition of two installations to the Environmental Protection Agency's National Priority Listing, and new information on the characterization of existing sites resulted in an upward revision of the cost estimates for prior year sites.

Environmental range liabilities are reversed to zero. Restoration cost for ordnance and their chemical contamination on closed ranges is estimated at approximately $595 million as of September 30, 2001. The estimate does not reflect the total potential restoration liability associated with ranges.

Non-DERP, Non-BRAC restoration liabilities increased by slightly more than $70 million during FY 2001. The increase is accounted for by the addition of just over $112 million for new reported liabilities during the year. The reported liability is expected to increase during FY 2002 as the Air Force expands reporting of these restoration activities. Reporting has expanded to include sites not reported previously and to reflect application of validated cost estimating tools. Likewise, accounting for the obligation and expenditure of funds on these restoration actions was established during FY 2001. Current liabilities for Non-DERP, Non-BRAC restoration liabilities cannot be determined because of lack of data concerning expenditures in this category.

This is the first statement that reports environmental disposal liabilities for the future closure of Air Force facilities. These disposal liabilities are for landfills of $12.2 million, underground storage tanks (USTs) of $7.5 million, and hazardous waste treatment, storage and disposal facilities (TSDFs) of $41.8 million. The liability for landfills and USTs are on an incremental basis using percentage of capacity to determine landfill liabilities and a twenty-year life to determine UST liabilities. If landfill and UST liabilities had been recognized on a total basis at September 30, 2001, it would have been $80.1 million and $41.8 million, respectively. TSDF disposal liabilities represent the one time closure cost estimate for each facility plus thirty years of monitoring following closure, as required by regulation. UST disposal liability is based on a twenty-year amortization of the one-time closure costs. Additionally, two years of annual monitoring costs are recognized in the year of closure. Landfill disposal liability is recognized on the basis of percentage of capacity used during the year. Percentage of usage during the year is multiplied by the one time closure cost estimate, and the liability is accrued annually based on usage. Once the landfill is closed, there is thirty years of annual monitoring cost added to the liability and recognized. The monitoring cost estimate is re-evaluated each year following closure. The accounting system currently does not track amounts obligated or expensed for these individual areas. Therefore, every year the initial liability will be reversed and the new liability established based on estimates made that year. The Air Force expects the disposal liability to increase during FY 2002 with improved reporting. The basis for the cost estimates used to establish the September 30, 2001 disposal liabilities were as follows:

TSDFs	58% used a validated process or an actual contract bid
	36% used historical cost as the basis
	6% used some other method
USTs	92% used a validated process or an actual contract bid
	8% used some other method
Landfills	99% used a validated process or an actual contract bid
	1% used some other method

The other methods generally listed engineering estimates based on generally accepted engineering techniques but not specifically validated by the Air Force. Current liabilities cannot be determined due to lack of expenditure data in these categories.

The Air Force Base Conversion Agency (AFBCA) estimates a $1.917 billion liability as of September 30, 2001. This amount includes all cleanup to meet regulatory requirements and to transfer property. However, this amount does not include potential future cost associated with long-term landfill management for which the Air Force may never be absolved of responsibility due to State laws. Pending implementation of DoD and Air Force guidance, an Air Force validated, verified and accredited method of calculating future costs will be available for the September 30, 2002 report.

The September 30, 2001 environmental disposal liability of $49.4 million in Other National Defense Weapon Systems includes strategic, tactical, active, inactive missiles and missile motors. The Air Force identified $48 million in environmental liability for the disposal of Minuteman III and Peacekeeper strategic, inactive missile motors. The estimated environmental disposal liability for tactical, active, inactive missiles and missile motors is $1.4 million.

Note 15.A. Other Liabilities

As of September 30,	2001			2000
	Current Liability	Noncurrent Liability	Total	Total
(Amounts in thousands)				
Intragovernmental:				
Advances from Others	$ 128,053	$ 0	$ 128,053	$ 126,900
Deposit Funds and Suspense Account Liabilities	1,265	0	1,265	3,694
Resources Payable to Treasury	604,501	0	604,501	542,245
Disbursing Officer Cash	612,013	0	612,013	176,632
Accounts Payable—Cancelled Appropriations	131,233	0	131,233	149,914
Judgement Fund Liabilities	136,308	281,001	417,309	360,355
IFECA Reimbursement to the Department of Labor	128,134	171,162	299,296	288,693
Other Liabilities	63,498	0	63,498	66,566
Total Intragovernmental Other Liabilities	$ 1,805,005	$ 452,163	$ 2,257,168	$ 1,714,999
Nonfederal:				
Accrued Funded Payroll and Benefits	$ 994,520	$ 0	$ 994,520	$ 145,318
Advances from Other	58,444	0	58,444	55,668
Deposit Funds and Suspense Accounts	7,128	0	7,128	21,146
Temporary Early Retirement Authority	14,200	21,800	36,000	43,800
Nonenvironmental Disposal Liabilities:				
Excess/Obsolete Structures	45,000	48,000	93,000	155,992
Accounts Payable—Cancelled Appropriations	80,666	0	80,666	181,141
Accrued Unfunded Annual Leave	1,745,593	0	1,745,593	1,750,695
Capital Lease Liability	355,064	107,132	462,196	235,090
Other Liabilities	4,282	637,150	641,432	656,633
Total Nonfederal Other Liabilities	$ 3,304,897	$ 814,082	$ 4,118,979	$ 3,245,483
Total Other Liabilities:	$ 5,109,902	$ 1,266,245	$ 6,376,147	$ 4,960,482

Intragovernmental

Accounts Payable-Canceled Appropriations—Unfunded liabilities from "M" accounts and closed years total to $211.9 million, which is included on the balance sheet. Although closed appropriation liability balances are unreliable, it is possible this liability will be liquidated using current year funding at the time of liquidation.

Judgement Fund Liabilities—Judgement Fund liabilities result from contractor claims under the Contracts Disputes Act on Air Force contracts that have been adjudicated by a court or a board in favor of the contractor. Initially, the Department of the Treasury pays the monetary awards to the contractor. However, subsequently the Air Force must reimburse the Treasury's Judgement Fund for the amount that was paid to the contractors.

Other Liabilities—The amount of $63.5 million represents military unemployment compensation of $31.3 million and $32.2 million of government contribution of employee benefits.

Non-Federal

Accrued Funded Payroll and Benefits—The increase is due to the accrual of the military payroll.

Nonenvironmental Disposal Liabilities

Included in the reported amounts are the current cost basis estimates for disposing of, or demolishing, approximately $93 million worth of excess/obsolete structures at active installations, in accordance with disposal plans directed by Defense Reform Initiative Directive No. 36, dated May 5,1998. The expected completion date is FY 2003.

The FY 2001 nonenvironmental ND PP&E (nonnuclear) disposal liability was $0; there were no missiles at the end of the fiscal year for which a formal management decision had been made to decommission. A potential maximum nonenvironmental disposal liability of $3.8 million was also determined based on the quantities of missiles and missile motors designated for disposal or identified in demilitarization plans. The maximum nonenvironmental disposal liability includes both strategic and tactical, active and inactive missiles and missile motors. The maximum nonenvironmental disposal liability for strategic missiles and missile motors was calculated to be $0. The maximum nonenvironmental disposal liability for tactical missiles and missile motors was $2.9 million for active missiles, $.9 million for inactive missiles, and $0 for missile motors

Accounts Payable-Canceled Appropriation—See above

Other Liabilities—The amount of $641.4 million represents legal contingencies of $637.1 million, civilian unemployment compensation of $3.6 million and accrued interest liability of $.7 million.

The recorded estimated probable liability amount of $4.2 million 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 $.4 million and is not included in the reported amount.

General Funds

The total estimated probable liability for claims and litigations against the Air Force handled by the Civil Law and Litigation Directorate, as of September 30, 2001, was valued at $534.2 million and has been included in the accompanying financial statements. As of September 30, 2001, the Air Force was party to 1,840 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 $1.1 billion 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. Rather, judgements over $100 thousand are ordinarily paid from the Judgement Fund, not from Air Force accounts even though claims were the result of Air Force operations. In many cases involving attorney fees, the amounts are not known until the last appeal is concluded.

As of September 30, 2001, the Air Force was a party to 149 contract appeals before the Armed Services Board of Contract Appeals (ASBCA). The probable amount of loss from contractor claims of $98.8 million has been reflected in the financial statements. The contractor claims involve unique circumstances that 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 $7.7 million and is not included in the reported amount.

Other

The Legal Representation Letter describes contingent liabilities from cases which may or may not be paid from the Treasury's Claims, Judgement, and Relief Acts Fund depending on the final outcome. Since Air Force appropriations do not necessarily pay for all judgements or settlements for cases and the probability of payments is unknown, these contingencies from pending cases are not reflected in the financial statement.

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

Note 15.B. Capital Lease Liability

As of September 30,	2001			2000
	Asset Category			
	Land and Buildings	Equipment	Total	Total
(Amounts in Thousands)				
Future Payments Due:				
2002	$ 45,433	$ 250	$ 45,683	$ 13,051
2003	45,433	167	45,600	14,284
2004	45,433	167	45,600	15,656
2005	45,433	0	45,433	17,184
2006	45,152	0	45,152	18,709
After 5 Years	234,813	0	234,813	156,205
Total Future Lease Payments Due	$ 461,697	$ 584	$ 462,281	$ 235,089
Less: Imputed Interest				
Executory Costs	163,798	59	163,857	0
Net Capital Lease Liability	$ 297,899	$ 525	$ 298,424	$ 235,089
Capital Lease Liabilities Covered by Budgetary Resources:			$ 355,149	$ 170,436
Capital Lease Liabilities Not Covered by Budgetary Resources:			$ 107,132	$ 64,654

The Air Force is the leasee in twelve capital leases. Eleven are for military family housing and one is for a piece of medical equipment. All leases prior to FY 1992 are funded on a FY basis. This correlates to six of the military family housing leases.

The piece of medical equipment asset value was decreased by $2,242.32 in FY 2002 from the renegotiation of the purchase price resulting in the annual payment reduction from approximately $250,000 to $167,000 for two years.

Note 16. Commitments and Contingencies

All disclosures related to known commitments and contingencies have been disclosed in the notes on Environmental Liabilities and Environmental Disposal Liabilities and Other Liabilities.

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

As of September 30,	2001	2001	2000
	Actuarial Present Value of Projected Plan Benefits	Unfunded Actuarial Liability	Unfunded Actuarial Liability
(Amounts in Thousands)			
FECA	$ 1,269,811	$ 1,269,811	$ 1,123,249

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 economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

FY 2001
5.21% in year 1
5.21% in year 2
and thereafter

To provide more specifically for the effects of inflation on the liability for FWC benefits, wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIMs) were applied to the calculation of projected future benefits. These factors were also used 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
2001	3.33%	4.44%
2002	3.00%	4.15%
2003	2.56%	4.09%
2004	2.50%	4.09%
2005+	2.50%	4.09%

The model's resulting projections were analyzed to insure 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 18. Unexpended Appropriations

As of September 30,	2001	2000
(Amounts in Thousands)		
Unexpended Appropriations:		
Unobligated, Available	$ 6,370,402	$ 6,232,288
Unobligated, Unavailable	832,884	872,765
Unexpended Obligations	31,803,503	28,225,881
Total Unexpended Appropriations	$ 39,006,789	$ 35,330,934

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.

Note 19.A. General Disclosures Related to the Statement of Net Cost

The amounts presented in the Statement of Net Cost are based on obligations and disbursements and therefore may not in all cases report actual accrued costs. The Air Force generally records transactions on a cash basis and not an accrual basis as is required by generally accepted accounting principles. Therefore, the Air Force's systems do not capture all actual costs. As such, information presented in the Statement of Net Cost is based on budgetary obligations, disbursements, and collection transactions, as well as nonfinancial feeder systems; and is adjusted to record known accruals for major items such as payroll expenses, accounts payable, environmental liabilities, etc. and known imputed expenses.

Note 19.B. Imputed Expenses

As of September 30,	2001	2000
(Amount in thousands)		
Civilian (e.g.,CSRS/FERS) Retirement	$ 204,481	$ 189,105
Civilian Health	365,643	342,289
Civilian Life Insurance	1,153	1,372
Judgment Fund/Litigation	15,587	2,677
Total Imputed Expenses	$ 586,864	$ 535,443

Note 19.C. Exchange Revenue

Goods and services provided through reimbursable programs to the public or another U.S. Government entity (intra-Air Force, intra-DoD or other federal government entity) are provided at cost. Such reimbursable sales are reported as earned revenues. Costs are equal to the amount reported as earned. Since FY 2000 sales to the Foreign Military Trust Fund and related cost of sales have been reclassified as non-federal, transactions with the public, rather than intragovernmental transactions as in years prior.

Note 19.D. Stewardship Assets

Stewardship assets include Heritage Assets, Stewardship Land and National Defense PP&E.

Costs for acquiring, constructing, improving, reconstructing, or renovating heritage assets; costs of acquiring stewardship land; and costs to prepare stewardship land for its intended use are required to be recognized and disclosed in the Statement of Net Cost or in the notes. Such costs, if any, are not separately identifiable and are not believed to be material.

Expenditures totaling $9.46 billion (excluding the cost of goods and services provided to others) are deemed to be for National Defense PP&E. The $9.46 billion represents $7.43 billion for national defense aircraft procurement and $2.03 billion for national defense missile procurement. The amounts are net of expenditures capitalized as operating materials and supplies (engines and other items) and are unadjusted for current year progress payments, which are capitalized. Outstanding progress payments will be expensed upon delivery of equipment. See note 6. These costs, adjusted for current year progress payments, are included in the Procurement Program Costs section of the Statement of Net Cost:

Note 19.E. Intragovernmental Revenue and Expense

The Air Force's accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the Air Force was unable to reconcile intragovernmental revenue balances with its trading partners. The Department intends to develop long-term systems improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliation can not be accomplished with the existing or foreseeable resources.

The Air Force's operating expenses were adjusted based on a comparison between the Air Force'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 Air Force were adjusted upwards in the amount of $985.1 million.

Note 20. Disclosures Related to the Statement of Changes in Net Position

As of September 30,	2001	2000
(Amounts in thousands)		
Prior Period Adjustments Increases (Decreases) to Net Position Beginning Balance:		
Changes in Accounting Standards	$ 37,561,527	$ 0
Errors and Omissions in Prior Year Accounting Reports	1,443,798	(1,093,611)
Other Prior Period Adjustments	0	(4,372,430)
Total Prior Period Adjustments	$ 39,005,325	$ (5,466,041)
Imputed Financing:		
Civilian CSRS/FERS Retirement	$ 204,481	$ 189,105
Civilian Health	365,643	342,289
Civilian Life Insurance	1,153	1,372
Judgement Fund/Litigation	15,587	2,677
Total Imputed Financing	$ 586,864	$ 535,443

Prior Period Adjustments consist of:

Implementation of change in DoD policy regarding National Defense Property, Plant and Equipment. Reclassification of engines and other aircraft equipment from National Defense Property and Equipment (off the balance sheet) to operating materials and supplies (on the balance sheet). Adjustment net of depreciation. $37,561,527

Adjustments to further implementation of the Automated Civil Engineer System used for reporting real property by correcting beginning of year balances 2,894,028

Adjustments of beginning balances carried in various equipment systems and records based on end of year balances and current year changes. Adjustment net of depreciation. . . . .(1,062,842)

Adjustment to correct duplication of amount reported in two systems. . . . .(133,667)

Adjustment to correct reporting of items in hands of contractor. . . . .(109,208)

Adjustments to correct assets under capital lease reporting. . . . .(144,513)

Total Prior Period Adjustments $39,005,325

Note 21.A. Disclosures Related to the Statement of Budgetary Resources

As of September 30,	2001	2000
(Amounts in thousands)		
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 32,552,586	$ 28,948,683

Unexpended Obligations presented in the Statement of Budgetary Resources (SBR) includes Unexpended Obligations for both direct and reimbursable funds.

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 SFFAS Number 1. Also, negative budgetary resources of $89 million (relating to Offsetting Receipts of Accounts shown on the Report on Budget Execution, or SF 133) are not included in the SBR (combined, combining or disaggregated).

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 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 OMB Circular A-34, “Instructions on Budget Execution” requirements. Although DFAS Denver Center developed an alternative methodology to calculate these items, the auditors and DFAS Denver Center concur 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.

Disaggregated SBR are included in the Required Supplementary Information section of the statements. The abnormal balance on the Unobligated Balances—Not Available in the Research, Development, Test, & Evaluation grouping relates to the cancellation of reimbursable authority at fiscal yearend.

Note 21.B. Disclosures Related to Problem Disbursements, In-transit Disbursements and Suspense/Budget Clearing Accounts

As of September 30,	2000	2001	Cumulative (Decrease)/ Increase
(Amounts in thousands)			
Problem Disbursements	$ 96	$ 46	$ (50)
In-transit Disbursements, Net	$ 1,283	$ 2,272	$ 989

The Air Force has $ 2.3 billion problem disbursements and in-transit disbursements that represent disbursements of Air Force funds that have been reported by a disbursing station to the Department of the Treasury but have not yet been precisely matched against the specific source obligation giving rise to the disbursements. For the most part, these payments have been made using available funds and based on valid receiving reports for goods and services delivered under valid contracts. The problem disbursements and in-transit disbursements arise when the various contracting, disbursing, and accounting systems fail to match the data necessary to properly account for the disbursement transactions in all applicable accounting systems. Defense Finance and Accounting Service has efforts underway to improve the systems and to resolve all previous problem disbursements and to process all in-transit disbursements. As of September 30, 2001, these efforts resulted in a $50 million decrease in reported problem disbursements. In-transits have increased $989 million since September 2000. In-transit disbursements increased primarily due to realignment of workload between the Field Sites to better serve our customers. This has caused delays in the processing of transactions as the transactions were routed to the incorrect accounting station and then had to be transferred to the correct accounting station. A secondary cause was the implementation of Departmental Cash Management System For and By Others (DFB) system. Implementation started in July 1999 and completed in July 2001. We experienced a four-month learning curve at each Field Site with this new system that also delayed the processing of by-others transactions. We anticipate significant benefits from both of these initiatives in fiscal year 2002. Previous year's reports have shown only aged in-transit disbursements. This report includes all in-transit disbursements for the two years shown.

Suspense/Budget Clearing Accounts

Account	Sep-00	Sep-01	(Decrease)/ Increase
F3875	$ 60,686	$ 9,579	$ (51,107)
F3880	(3,187)	(1,514)	1,673
F3885	468,660	494,240	25,580
F3886	0	5	5
Total	$ 526,159	$ 502,310	$ (23,849)

The Air Force has made 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 significant reductions (with the exception noted below) that the Air Force has achieved in the various suspense/budget clearing accounts.

The large increases in F3885 for FY 2000 and FY 2001 are due to numerous OPAC transactions received during the last business day of September that, by established procedure, are placed in this suspense account until they can be assigned to a valid appropriation.

On September 30 of each fiscal year, all of the uncleared suspense/budget clearing account balances are reduced to zero by transferring the balances to proper appropriation accounts using a logical methodology, such as prorating the amounts on a percentage basis derived by comparing the disbursements in the suspense/clearing account to total disbursements.

The amounts in brackets in account F3880 represent collections.

Note 22. Disclosures Related to the Statement of Financing

Intra-entity transactions have not been eliminated. The accompanying Statements of Financing are presented as combined or combining statements.

Financing Imputed for Cost Subsidies of $586.9 million consists of the imputed financing items listed in the note on disclosures related to the Statement of Changes in Net Position.

The components and total of liabilities not covered by budgetary resources are disclosed in the note on liabilities that presents liabilities covered and not covered by budgetary resources.

Note 23. Disclosures Related to the Statement of Custodial Activity

Not Applicable.

Note 24. Other Disclosures

Entity As Leassee—Operating Leases

Medical Equipment—Operating leases are one year leases with four option years. Each year, facilities must specifically exercise the option to continue the lease. The operating leases that contain an option to purchase allows the government to purchase the equipment at fair market value at the end of the lease period.

Military Family Housing—The figures represent operating leased facilities in the U.S. and overseas applicable to active Air Force, Air Force Reserve and Air National Guard.

Motor Vehicles—Operating Leases for Motor Vehicles are essentially one year leases funded in appropriation 3400 (O&M). As the out year estimates indicate, Air Force expects to continue to reduce the level of owned assets, while increasing the number of operational leases. Air Force will continue to displace commercial leases in favor of IFMS (General Services Administration) leases because IFMS leases are typically more economical.

As of September 30,	2001				2000
(Amounts in thousands)	Equipment	Military Family Housing	Motor Vehicles	Total	Total
Future Payments Due:					
Fiscal Year					
2002	$ 1,772	$ 43	$ 226	$ 2,041	$ 1,378
2003	1,559	43	250	1,852	1,335
2004	1,143	44	257	1,444	1,061
2005	485	45	0	530	644
2006	349	46	0	395	0
Total Future Lease Payments Due	$ 5,308	$ 221	$ 733	$ 6,262	$ 4,418

Note 24.A. Other Disclosures

Interest Payable: DFAS Columbus has accumulated prompt payment interest of approximately $.7 million during FY 2001 for Air Force contracts. The interest payments were not made because the unpaid invoices are under a reconciliation process in an interest-bearing mode.

Undistributed Collections and Disbursements: Accounts receivable and payable are adjusted for undistributed collections and disbursements. These transactions represent the Air Force's in-float (undistributed) collections and disbursements for transactions that were reported by a disbursing station but not recorded by the appropriate accountable station. Undistributed amounts are prorated by appropriation based on the percentage of distributed government and public receivables and payables.

Canceled Balances: All unliquidated balances associated with closed accounts have been canceled in accordance with Public Law 101-510. Canceled accrued expenditures unpaid are reflected in the financial statements as unfunded liabilities. Canceled undelivered orders outstanding are not included in the financial statements; however, these orders may result in future expenditures. Due to systems deficiencies, canceled receivables are included in the Air Force Balance Sheet. Canceled-year appropriation balances for receivables and payables are not reliable.

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General Funds

Consolidating and Combining Statements

Consolidating Balance Sheet—General Funds

As of September 30 ($ in Thousands)

	Air Force Active	Air Force Reserve	Air National Guard
ASSETS *(Note 2)*			
Intragovernmental:			
Fund Balance with Treasury *(Note 3)*	$ 42,337,943	$ 657,691	$ 1,264,154
Investments *(Note 4)*	1,088	0	0
Accounts Receivable *(Note 5)*	503,659	10,675	94,676
Other Assets *(Note 6)*	283,337	53,215	15,161
Total Intragovernmental Assets	$ 43,126,027	$ 721,581	$ 1,373,991
Cash and Other Monetary Assets *(Note7)*	$ 486,225	$ 0	$ 0
Accounts Receivable *(Note 5)*	549,624	4,582	7,563
Inventory and Related Property *(Note 9)*	53,837,743	531,225	3,241,387
General Property, Plant and Equipment *(Note 10)*	16,823,835	716,507	2,903,806
Other Assets *(Note 6)*	5,505,710	2,024	1,870
TOTAL ASSETS	$ 120,329,164	$ 1,975,919	$ 7,528,617
LIABILITIES *(Note 11)*			
Intragovernmental:			
Accounts Payable *(Note 12)*	$ 691,909	$ 109,445	$ 132,804
Debt *(Note 13)*	108	0	0
Other Liabilities *(Note 15 & 16)*	2,257,927	5,344	14,828
Total Intragovernmental Liabilities	$ 2,949,944	$ 114,789	$ 147,632
Accounts Payable *(Note 12)*	$ 4,019,835	$ 73,983	$ 86,599
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	909,370	134,087	226,354
Environmental Liabilities *(Note 14)*	7,312,942	0	0
Other Liabilities *(Note 15 & 16)*	4,024,403	22,244	72,332
TOTAL LIABILITIES	$ 19,216,494	$ 345,103	$ 532,917
NET POSITION			
Unexpended Appropriations *(Note 18)*	$ 37,344,088	$ 524,914	$ 1,137,787
Cumulative Results of Operations	63,768,582	1,105,902	5,857,913
TOTAL NET POSITION	$ 101,112,670	$ 1,630,816	$ 6,995,700
TOTAL LIABILITIES AND NET POSITION	$ 120,329,164	$ 1,975,919	$ 7,528,617

The accompanying notes are an integral part of the financial statements.
See notes 1 and 21.

Combined Total		Intra-entity Eliminations		FY 2001 Consolidated Total		FY 2000 Consolidated Total
$	44,259,788	$ 0		44,259,788	$	40,541,322
	1,088	0		1,088		1,303
	609,010	214,497		394,513		284,642
	351,713	7		351,706		185,293
$	45,221,599	$ 214,504	$	45,007,095	$	41,012,560
$	486,225	$ 0	$	486,225	$	64,982
	561,769	0		561,769		506,228
	57,610,355	0		57,610,355		19,269,788
	20,444,148	0		20,444,148		20,536,756
	5,509,604	0		5,509,604		4,802,609
$	129,833,700	$ 214,504	$	129,619,196	$	86,192,923
$	934,158	$ 193,573	$	740,585	$	997,903
	108	0		108		109
	2,278,099	20,931		2,257,168		1,714,999
$	3,212,365	$ 214,504	$	2,997,861	$	2,713,011
$	4,180,417	$ 0	$	4,180,417	$	4,174,733
	1,269,811	0		1,269,811		1,123,249
	7,312,942	0		7,312,942		7,715,253
	4,118,979	0		4,118,979		3,245,483
$	20,094,514	$ 214,504	$	19,880,010	$	18,971,729
$	39,006,789	$ 0	$	39,006,789	$	35,330,934
	70,732,397	0		70,732,397		31,890,260
$	109,739,186	$ 0	$	109,739,186	$	67,221,194
$	129,833,700	$ 214,504	$	129,619,196	$	86,192,923

The accompanying notes are an integral part of the financial statements.
See notes 1 and 21.

General Funds Consolidating and Combining Statements

Consolidating Statement of Net Cost—General Funds

For the years ended September 30 ($ in Thousands)

	Air Force Active	Air Force Reserve	Air National Guard
Program Costs			
Military Personnel			
Intragovernmental	$ 2,994,307	$ 173,504	$ 227,491
With the Public	15,595,824	812,017	1,498,242
Total Program Cost	$ 18,590,131	$ 985,521	$ 1,725,733
(Less: Earned Revenue)	(193,513)	0	(23,275)
Net Program Costs	$ 18,396,618	$ 985,521	$ 1,702,458
Operation and Maintenance			
Intragovernmental	$ 12,014,079	$ 959,809	$ 2,053,910
With the Public	15,544,776	1,355,961	2,250,425
Total Program Cost	$ 27,558,855	$ 2,315,770	$ 4,304,335
(Less: Earned Revenue)	(2,063,641)	(45,806)	(246,622)
Net Program Costs	$ 25,495,214	$ 2,269,964	$ 4,057,713
Procurement			
Intragovernmental	$ 487,727	$ 0	$ 0
With the Public	16,508,176	0	0
Total Program Cost	$ 16,995,903	$ 0	$ 0
(Less: Earned Revenue)	(65,767)	0	0
Net Program Costs	$ 16,930,136	$ 0	$ 0
Research, Development, Test & Evaluation			
Intragovernmental	$ 247,507	$ 0	$ 0
With the Public	14,889,595	0	0
Total Program Cost	$ 15,137,102	$ 0	$ 0
(Less: Earned Revenue)	(664,022)	0	0
Net Program Costs	$ 14,473,080	$ 0	$ 0
Military Construction/Family Housing			
Intragovernmental	$ 4,735	$ 624	$ 381
With the Public	4,845,063	63,043	448,457
Total Program Cost	$ 4,849,798	$ 63,667	$ 448,838
(Less: Earned Revenue)	(13)	0	0
Net Program Costs	$ 4,849,785	$ 63,667	$ 448,838
Other			
Intragovernmental	$ 5,164	$ 0	$ 0
With the Public	(3,853)	0	0
Total Program Cost	$ 1,311	$ 0	$ 0
(Less: Earned Revenue)	(71)	0	0
Net Program Costs	$ 1,240	$ 0	$ 0
Total Program Costs			
Intragovernmental	$ 15,753,519	$ 1,133,937	$ 2,281,782
With the Public	67,379,581	2,231,021	4,197,124
Total Program Cost	$ 83,133,100	$ 3,364,958	$ 6,478,906
(Less: Earned Revenue)	(2,987,027)	(45,806)	(269,897)
Net Program Costs	$ 80,146,073	$ 3,319,152	$ 6,209,009
Costs Not Assigned to Programs	0	0	0
(Less: Earned Revenue not attributable to Programs)	0	0	0
Net Costs of Operations	$ 80,146,073	$ 3,319,152	$ 6,209,009

The accompanying notes are an integral part of the financial statements.
See notes 1 and 19.

Combined Total	Intra-entity Eliminations	FY 2001 Consolidated Total	FY 2000 Consolidated Total
$ 3,395,302	$ 54,097	$ 3,341,205	$ 3,397,794
17,906,083	0	17,906,083	16,999,516
$ 21,301,385	$ 54,097	$ 21,247,288	$ 20,397,310
(216,788)	(20,078)	(196,710)	(244,797)
$ 21,084,597	$ 34,019	$ 21,050,578	$ 20,152,513
$ 15,027,798	$ 441,496	$ 14,586,302	$ 13,309,059
19,151,162	0	19,151,162	19,540,254
$ 34,178,960	$ 441,496	$ 33,737,464	$ 32,849,313
(2,356,069)	(475,250)	(1,880,819)	(1,972,357)
$ 31,822,891	$ (33,754)	$ 31,856,645	$ 30,876,956
$ 487,727	$ 629	$ 487,098	$ 720,642
16,508,176	0	16,508,176	13,086,014
$ 16,995,903	$ 629	$ 16,995,274	$ 13,806,656
(65,767)	0	(65,767)	(162,385)
$ 16,930,136	$ 629	$ 16,929,507	$ 13,644,271
$ 247,507	$ 533	$ 246,974	$ 319,236
14,889,595	0	14,889,595	14,488,087
$ 15,137,102	$ 533	$ 15,136,569	$ 14,807,323
(664,022)	(1,439)	(662,583)	(579,438)
$ 14,473,080	$ (906)	$ 14,473,986	$ 14,227,885
$ 5,740	$ 11	$ 5,729	$ 16,755
5,356,563	0	5,356,563	1,121,123
$ 5,362,303	$ 11	$ 5,362,292	$ 1,137,878
(13)	0	(13)	0
$ 5,362,290	$ 11	$ 5,362,279	$ 1,137,878
$ 5,164	$ 0	$ 5,164	$ 662
(3,853)	0	(3,853)	1,043
$ 1,311	$ 0	$ 1,311	$ 1,705
(71)	0	(71)	(72)
$ 1,240	$ 0	$ 1,240	$ 1,633
$ 19,169,238	$ 496,766	$ 18,672,472	$ 17,764,148
73,807,726	0	73,807,726	65,236,037
$ 92,976,964	$ 496,766	$ 92,480,198	$ 83,000,185
(3,302,730)	(496,767)	(2,805,963)	(2,959,049)
$ 89,674,234	$ (1)	$ 89,674,235	$ 80,041,136
0	0	0	0
0	0	0	0
$ 89,674,234	$ (1)	$ 89,674,235	$ 80,041,136

The accompanying notes are an integral part of the financial statements.
See notes 1 and 19.

General Funds Consolidating and Combining Statements

Consolidating Statement of Changes in Net Position—General Funds

For the years ended September 30 ($ in Thousands)

		Air Force Active		Air Force Reserve		Air National Guard
Net Cost of Operations	$	80,146,072	$	3,319,152	$	6,209,009
Financing Sources (other than exchange revenues)						
Appropriations Used		77,460,754		3,061,108		5,613,243
Taxes and Other Nonexchange Revenue		0		0		0
Donations - Nonexchange Revenue		5,872		0		0
Imputed Financing		586,864		0		0
Transfers - in		294,534		188,002		1,622,136
Transfers - out		(1,648,412)		0		0
Other		1,838,757		(13,457)		411,122
Total Financing Sources (other than Exchange Revenues)	$	78,538,369	$	3,235,653	$	7,646,501
Net Results of Operations	$	(1,607,703)	$	(83,499)	$	1,437,492
Prior Period Adjustments		35,539,133		815,685		2,650,507
Net Change in Cumulative Results of Operations	$	33,931,430	$	732,186	$	4,087,999
Increase (Decrease) in Unexpended Appropriations		3,840,214		(50,577)		(23,263)
Change in Net Position	$	37,771,644	$	681,609	$	4,064,736
Net Position-Beginning of the Period		63,341,025		949,206		2,930,964
Net Position-End of the Period	$	101,112,669	$	1,630,815	$	6,995,700

General Funds Consolidating and Combining Statements

The accompanying notes are an integral part of the financial statements.
See notes 1 and 20.

Combined Total	Intra-entity Eliminations	FY 2001 Consolidated Total	FY 2000 Consolidated Total
$ 89,674,233	$ 0	$ 89,674,233	$ 80,041,135
86,135,105	0	86,135,105	82,974,178
0	0	0	0
5,872	0	5,872	2,450
586,864	0	586,864	535,443
2,104,672	1,630,671	474,001	75,431
(1,648,412)	(1,630,671)	(17,741)	0
2,236,422	0	2,236,422	0
$ 89,420,523	$ 0	$ 89,420,523	$ 83,587,502
$ (253,710)	$ 0	$ (253,710)	$ 3,546,367
39,005,325	0	39,005,325	(5,466,041)
$ 38,751,615	$ 0	$ 38,751,615	$ (1,919,674)
3,766,374	0	3,766,374	(614,650)
$ 42,517,989	$ 0	$ 42,517,989	$ (2,534,324)
67,221,195	0	67,221,195	69,755,519
$ 109,739,184	$ 0	$ 109,739,184	$ 67,221,195

The accompanying notes are an integral part of the financial statements.
See notes 1 and 20.

Combining Statement of Budgetary Resources—General Funds

For the years ended September 30 ($ in Thousands)

	Air Force Active	Air Force Reserve
BUDGETARY RESOURCES		
Budget Authority	$ 84,339,994	$ 2,929,900
Unobligated Balance - Beginning of Period	6,804,101	104,486
Net Transfers Prior Year Balance, Actual	(2,262,070)	43,974
Spending Authority from Offsetting Collections	4,893,575	47,733
Adjustments	(727,333)	3,044
Total Budgetary Resources	$ 93,048,267	$ 3,129,137
STATUS OF BUDGETARY RESOURCES		
Obligations Incurred	$ 86,173,544	$ 3,012,250
Unobligated Balances - Available	6,205,419	23,572
Unobligated Balances - Not Available	669,304	93,315
Total, Status of Budgetary Resources	$ 93,048,267	$ 3,129,137
OUTLAYS		
Obligations Incurred	$ 86,173,544	$ 3,012,250
Less: Spending Authority from Offsetting Collections and Adjustments	(6,092,981)	(74,906)
Obligated Balance, Net - Beginning of Period	31,776,000	648,595
Less: Obligated Balance, Net - End of Period	(35,455,895)	(540,801)
Total Outlays	$ 76,400,668	$ 3,045,138

The accompanying notes are an integral part of the financial statements.
See notes 1 and 21.

	Air National Guard		FY 2001 Combined Total		FY 2000 Combined Total
$	5,447,407	$	92,717,301	$	83,748,021
	196,465		7,105,052		7,308,408
	87,993		(2,130,103)		227,055
	269,925		5,211,233		5,053,092
	18		(724,271)		(990,216)
$	6,001,808	$	102,179,212	$	95,346,360
$	5,790,132	$	94,975,926	$	88,241,307
	141,411		6,370,402		6,232,287
	70,265		832,884		872,766
$	6,001,808	$	102,179,212	$	95,346,360
$	5,790,132	$	94,975,926	$	88,241,307
	(315,468)		(6,483,355)		(6,508,028)
	986,166		33,410,761		34,001,921
	(1,052,477)		(37,049,173)		(33,410,761)
$	5,408,353	$	84,854,159	$	82,324,439

General Funds Consolidating and Combining Statements

The accompanying notes are an integral part of the financial statements.
See notes 1 and 21.

Combining Statement of Financing—General Funds

For the years ended September 30 ($ in Thousands)

	Air Force Active	Air Force Reserve
OBLIGATIONS AND NONBUDGETARY RESOURCES:		
Obligations Incurred	$ 86,173,544	$ 3,012,250
Less: Spending Authority from Offsetting Collections and Adjustments	(6,092,981)	(74,906)
Financing Imputed for Cost Subsidies	586,864	0
Transfers-In (Out)	(17,417)	0
Less: Exchange Revenue Not in the Entity's Budget	(2,731)	0
Less: Trust or Special Fund Receipts Related to Execution of Entity's Budget	0	0
Total Obligations as Adjusted and Nonbudgetary Resources	$ 80,647,279	$ 2,937,344
RESOURCES THAT DO NOT FUND NET COST OF OPERATIONS:		
Change in Amount of Goods, Services, and Benefits Ordered but not Received or Provided (Increases)/Decreases	$ (2,665,114)	$ 123,764
Change in Unfilled Customer Orders	23,238	0
Costs Capitalized on the Balance Sheet - (Increases)/Decreases	(3,353,924)	(61,458)
Financing Sources that Fund Costs of Prior Periods	575,405	(190)
Total Resources That Do Not Fund Net Costs of Operations	$ (5,420,395)	$ 62,116
COMPONENTS OF COSTS OF OPERATIONS THAT DO NOT REQUIRE OR GENERATE RESOURCES:		
	0	0
Depreciation and Amortization	$ 2,623,366	$ 36,015
Bad Debts Related to Uncollectable Non-Credit Reform Receivables	0	0
Revaluation of Assets and Liabilities - Increases/(Decreases)	(241,425)	1,310
Loss on Disposition of Assets	3,133,808	52,254
Other - (Increases)/Decrease	351,810	0
Total Costs That Do Not Require Resources	$ 5,867,559	$ 89,579
FINANCING SOURCES TO BE PROVIDED	$ 416,091	$ 18,104
NET COST OF OPERATIONS	$ 81,510,534	$ 3,107,143

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

See notes 1 and 22.

Air National Guard	FY 2001 Combined Total	FY 2000 Combined Total
$ 5,790,132	$ 94,975,926	$ 88,241,307
(315,468)	(6,483,355)	(6,508,028)
0	586,864	535,443
0	(17,417)	75,431
0	(2,731)	(406)
0	0	(72)
$ 5,474,664	$ 89,059,287	$ 82,343,675
$ 138,503	$ (2,402,847)	$ 851,353
76	23,314	(87,354)
(1,154,169)	(4,569,551)	(8,401,800)
(680)	574,535	60,810
$ (1,016,270)	$ (6,374,549)	$ (7,576,991)
0	0	0
$ 235,919	$ 2,895,300	$ 888,923
0	0	1,600
224,344	(15,771)	6,953,905
104,944	3,291,006	20,162
0	351,814	(4,601,822)
$ 565,207	$ 6,522,349	$ 3,262,768
$ 32,953	$ 467,148	$ 2,011,685
$ 5,056,554	$ 89,674,235	$ 80,041,137

The accompanying notes are an integral part of the financial statements.
See notes 1 and 22.

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

General Funds

Required Supplementary Stewardship Information

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Heritage Assets

	Measurement Quantities	As of 10/01/00	Additions	Deletions	As of 9/30/01
Museums	Each	20	0	1	19
Monuments & Memorials	Each	151	0	0	151
Cemeteries & Archeological Sites	Sites	1,360	197	0	1,557
Buildings & Structures	Each	4,027	313	0	4,340
Major Collections	Each	3	1	0	4

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 18 Air Force museums are considered Air Force Field Museums or Heritage Centers, which also contain items of historical interest.

During FY 2001, the beginning balances of the AF Museums and the Major Collections categories have been restated. At the end of FY 2000, the AF reported 14 museums and 8 major collections. Based on additional guidance, 5 of the major collections have been reclassified and moved to the museum category. In addition, one significant Heritage Center was inadvertently omitted from the list. During FY 2001, no museums were added to the Air Force inventory. However, McClellan Aviation Museum was deleted (privatized), as the result of the closure of McClellan AFB. All are reported in acceptable condition.

Monuments and Memorials

Of the151 monuments and memorials, 123 are 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 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.

Cemeteries & Archeological Sites

The Air Force has administrative and curatorial responsibilities for 39 cemeteries on its bases. The cemeteries are maintained by the bases and are in good condition. The Air Force has 1,518 archeological sites, including both listed archeological sites and eligible archeological sites. In addition, the Air Force has 10,362 potentially eligible archeological sites that are not listed on this report. The increase over last year's figure is a result of the completion of more archeological surveys, making more sites eligible to be classified as an archeological site, and bringing the data into agreement with the Federal Archeology Report (March 01).

Buildings and Structures

The Air Force currently considers 4,340 buildings and structures as heritage assets. In FY 2001, the Air Force performed a closer review of its heritage asset data. The review captured previously unreported structures and refined reporting criteria of heritage assets, such as reporting a garage structure not attached to a house as a separate structure from the house. The result was an increase of 313 heritage structures. Most of these buildings and structures are considered Multi-use Heritage Assets, and as such, have been reported as general property, plant and equipment on the Balance Sheet. The buildings and structures are maintained by each base civil engineering group and are considered to be in good condition.

Major Collections

The Air Force has 4 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. During FY 2001, the Air Force Academy identified the Gimbel Collection as a significant collection to be reported separately. The major collections beginning balance of eight collections (FY 2000 ending balance) has been restated based on FY 2001 Form and Content. The Air Force now considers five heritage centers and their contents as museums rather than collections. The curators for all major collections reported the contents to be in good condition. Almost all of the materials are protected in an environment suitable for long-term storage.

Stewardship Land

(Acres, in Thousands)

(a) Land Use	(b) As of 10/01/00	(c) Additions	(d) Deletions	(e) As of 9/30/01
Mission	7,733	4	3	7,734

The Air Force has 7,734 acres of mission-essential 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

(in Millions of Dollars)

Categories	FY 1999	FY 2000	FY 2001
Funded Assets:			
National Defense Mission Related	$16.60	$6.80	$20.20

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 supporting 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 Advisory Board Requirements.

Investments in Research and Development
Yearly Investment in Research and Development

(in Millions of Dollars)

Categories	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001
1. Basic Research	$228	$212	$206	$193	$230
2. Applied Research	650	583	562	547	582
3. Development					
Advanced Technology Development	652	491	483	496	522
Demonstration and Validation	890	1,190	1,295	1,013	1,039
Engineering and Manufacturing Development	4,667	4,371	4,200	3,991	3,776
Research, Development, Test and Evaluation Management Support	1,116	1,097	934	805	747
Operational Systems Development	6,232	6,798	6,810	7,062	7,377
Totals	$14,435	$14,742	$14,490	$14,107	$14,273

Basic Research—The Air Force's Defense Research Sciences basic research program funded basic scientific disciplines that are core to developing future warfighting capabilities. Funding was provided to twelve scientific projects, with one project focused on education programs for scientists and engineers and on international programs. The scientific projects were focused on atmospherics, biological sciences, chemistry, electronics, fluid mechanics, human performance, materials, mathematical and computer sciences, physics, propulsion, space sciences, and structures. Basic research in self-healing polymer composites will provide longer life for space structures and materials. Research in tracking algorithms will improve tracking of ground moving targets.

Applied Research—The Air Force's Applied Research program is developing technologies to support both an air and space force of the future. Technology developments are focused in those areas that are essential to future warfighting capabilities.

(1) One example is development of simulations of spontaneous magnetic field generation in plasma. This is a step toward three-dimensional prototyping of high-powered microwave sources.

(2) Another example is the cloning of the nitrate reductase gene of the anthrax bacteria into e. coli, providing a safe stimulant for the Agent Defeat weapons test program.

Development—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:

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.

(1) One technology achievement is the demonstration of automatic intrusion detection environment capabilities at nine operational sites. This provides near-real-time cyber attack warning at local, regional, and global levels.

(2) Another achievement includes development of the only SAE-certified, non-petroleum based, environmentally friendly, cost-effective deicer in the world.

Demonstration and Validation—The Air Force's demonstration and validation programs are comprised of system specific advanced technology integration efforts accomplished in an operational environment to help expedite transition from the laboratory to operational use.

An example of the Air Force's Demonstration and Validation effort is the Combat Identification Developed, Enhanced Recognition and Sensing Laser Radar (ERASER) system, a new tool for non-cooperative, ground target identification. ERASER allows attack aircraft to stand off at longer ranges when employing weapons, increasing effectiveness/survivability, and reducing fratricide. ERASER consists of a modified laser designator and an extremely sensitive infrared camera. During this year, the Air Force conducted a flight test program of the ERASER system.

Engineering Manufacturing and Development—The Air Force's engineering and manufacturing development (EMD) efforts are development projects which have not received approval for full-production.

(1) An example of the Air Force EMD is Joint Direct Attack Munitions (JDAM), a low cost, autonomously controlled, adverse weather, global position system aided inertial navigation guidance kit for the Air Force/Navy 1,000 pound (MK-83), 2,000 pound (MK-84 and BLU-109), and 500 pound (MK-82) general purpose bombs.

(2) Another example is the successful completion of the Joint Strike Concept Demonstration Program (CDP) in FY 2001. All CDP flight-testing is complete and flight test results have met or exceeded expectations. The CDP program demonstrated a) commonality and modularity among the JSF variants, b) slow speed handling qualities for the Carrier Variant, and c) Short Takeoff/Vertical Landing (STOVL) hover and transition capability.

RDT&E Management Support—The Air Force's Research, Development, Test and Evaluation (RDT&E) Management Support efforts include projects directed toward support of installations or operations required for general research and development use.

(1) An examples is the GPS Range Integration which greatly enhances Eglin's Range Time-Space-Position-Information (TSPI) reducing the number of support aircraft required per test while allowing for more complex mission scenarios. GPS Range Integration supports JDAM, AGM-130H, AIM-9X, F-22, joint service exercises and future DT&E and OT&E tests.

(2) Another example is the Advanced Data Acquisition and Processing System (ADAPS). The ADAPS project is located at Edwards AFB, and provides advanced, high rate, end-to-end, timely flight test data processing that meets complex program test requirements that the previous systems could not meet. Programs supported by ADAPS include JSF, F-22, C-17, Global Hawk, JDAM, AIM-9X and others.

Operational Systems Development—The Air Force's operational system efforts include projects in support of development acquisition programs or upgrades in SDD

(1) An example is the C-17 Required Navigation Performance RNP-4, providing the C-17 with continuous navigation performance without time limitations and allowing required air traffic control data to be transmitted via a high frequency data link. Development of design and requirement integration efforts continued this year.

(2) Another example is the C-5 Reliability Enhancement & Reengineering Program (RERP), which improves C-5 reliability, maintainability & availability and reduces total ownership cost. By replacing the power plant and fixing unreliable system components, C-5 RERP increases capability, throughput and access to GATM airspace. In November 2001, C-5 RERP completed Milestone B, as approved by the Defense Acquisition Board. A SDD Contract is expected to be awarded to Lockheed Martin in 2001.

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General Funds

Required Supplementary Information

General Funds Required Supplementary Information

Disaggregated Statement of Budgetary Resources—General Funds

For the years ended September 30 ($ in Thousands)

	Military Personnel	Operation and Maintenance	Procurement	Research, Development, Test & Evaluation
BUDGETARY RESOURCES				
Budget Authority	$ 20,955,776	$ 30,226,589	$ 25,626,542	$ 14,509,655
Unobligated Balance - Beginning of Period	270,534	786,695	3,520,194	2,068,588
Net Transfers Prior-Year Balance, Actual	48,764	607,489	(2,754,778)	(17,943)
Spending Authority from Offsetting Collections	213,442	3,030,597	108,638	1,841,066
Adjustments	(83,540)	239,316	(690,798)	(204,239)
Total Budgetary Resources	$ 21,404,976	$ 34,890,686	$ 25,809,798	$ 18,197,127
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred	$ 21,240,098	$ 34,233,552	$ 21,657,734	$ 16,479,739
Unobligated Balances - Available	18,580	70,708	4,050,764	1,741,774
Unobligated Balances - Not Available	146,298	586,426	101,299	(24,386)
Total, Status of Budgetary Resources	$ 21,404,976	$ 34,890,686	$ 25,809,797	$ 18,197,127
OUTLAYS				
Obligations Incurred	$ 21,240,098	$ 34,233,552	$ 21,657,734	$ 16,479,739
Less: Spending Authority from Offsetting Collections and Adjustments	(257,859)	(3,675,349)	(524,721)	(1,976,306)
Obligated Balance, Net - Beginning of Period	675,050	9,204,712	16,284,091	5,533,339
Obligated Balance Transferred, Net				
Less: Obligated Balance, Net - End of Period	(1,749,314)	(9,624,981)	(18,182,537)	(5,760,646)
Total Outlays	$ 19,907,975	$ 30,137,934	$ 19,234,567	$ 14,276,126

General Funds Required Supplementary Information

Military Construction/ Family Housing	Other General Funds	FY 2001 Combined Total	FY 2000 Combined Total
$ 1,391,310	$ 7,429	$ 92,717,301	$ 83,748,021
455,640	3,403	7,105,052	7,308,407
(13,635)	0	(2,138,103)	227,055
1,190	16,299	5,211,233	5,053,093
15,818	(828)	(724,271)	(990,217)
$ 1,850,323	$ 26,303	$ 102,179,212	$ 95,346,359
$ 1,341,245	$ 23,557	$ 94,975,926	$ 88,241,306
485,831	2,746	6,370,402	6,232,287
23,247	0	832,884	872,765
$ 1,850,323	$ 26,303	$ 102,179,212	$ 95,346,358
$ 1,341,245	$ 23,557	$ 94,975,926	$ 88,241,306
(32,820)	(16,299)	(6,483,355)	(6,508,028)
1,712,467	1,102	33,410,761	34,001,921
(1,726,258)	(5,436)	(37,049,173)	(33,410,761)
$ 1,294,634	$ 2,924	$ 84,854,159	$ 82,324,438

General Property Plant and Equipment
Real Property Deferred Sustainment Tables

(Amounts in Thousands)

Buildings & Structures	Fiscal Year 2001		
	Annual Sustainment		
	Required	Actual	Difference
Facilities (O&M)	$1,738, 690	$1,609,950	$128,740
Mil Family Housing	660,660	420,930	239,730
Total	$2,399,350	$2,030,880	$368,470

Sustainment requirements for facilities were extracted from the Facility Sustainment Model (FSM) version 3.0, dated 8 Oct 2001 (less MILPERS contribution (49%)) and deflated to FY 2001 using SAF/FMCEE published inflation indices. Sustainment actuals were developed based on 85% of FY 2001 maintenance, repair and minor construction (not including demolition).

The military family housing sustainment requirement is based on a combination of historical expenditures for day-to-day maintenance and condition assessment surveys for real property maintenance by contract (RPMC). These requirements are published in the 1999 Family Housing Master Plan.

Deferred sustainment includes amounts for multi-use heritage assets. It does not include the FY 2001 Air Force backlog of $21.2 billion ($9.6 billion non-Military Family Housing (MFH) MILCON, $4.8 billion MFH MILCON, and $6.8 billion O&M).

National Defense Property, Plant, and Equipment
Deferred Maintenance Amounts

(Amounts in Thousands)

1. Aircraft	$59,600
2. Other Weapons Systems	107,900
Total	$167,500

The readiness of Air Force facilities is assessed using the Installation Readiness Report (IRR). The IRR assigns C-ratings ranging from C-4 (worst) to C-1 (best). Facilities are aggregated in nine facility classes. The FY 2000 IRR indicates that 64% of Air Force facilities are rated C-4 or C-3 (i.e. below minimal acceptable performance).

The figures presented above are estimated amounts for FY01 from the Fiscal Year 2003 Amended Budget Estimate Submission (ABES). The figures include amounts for Active Air Force and Air National Guard. The Air Force Reserve reported no deferred maintenance for FY01 from the FY 2003 ABES. Other Weapons Systems include engines ($21.9 million), software ($57.9 million), other major end items ($19.3 million), non-Materiel Support Division ($6.1 million), area, base and manufacturing support ($2.4 million) and storage ($.3 million).

DoD Intra-governmental Asset Balances ($ Amounts in Thousands)	Treasury Index	Fund Balance with Treasury	Accounts Receivable	Investments	Other
Executive Office of the President	11		($3,562)		
Department of Agriculture	12		$1,479		
Department of Commerce	13		$1,182		
Department of the Interior	14		$112		
Department of Justice	15		$3,184		
Department of Labor	16		$32		
Navy General Fund	17		$23,659		
United States Postal Service	18		$71		
Department of State	19		$2,756		
Department of the Treasury	20	$44,259,788	$4,097	$1,088	
Army General Fund	21		$27,094		$1,021
Office of Personnel Management	24		$20		
Social Security Administration	28		$9		
Department of Veterans Affairs	36		$44		
General Service Administration	47		$2,168		
National Science Foundation	49		$579		
Federal Emergency Management Agency	58		$989		
Environmental Protection Agency	68		$1,142		
Department of Transportation	69		$29,256		
Agency for International Development	72		$7,552		
Department of Health and Human Services	75		$30		
National Aeronautics and Space Administration	80		$22,805		
Department of Energy	89		$21,060		
Department of Education	91		$451		
US Army Corps of Engineers	96		$58		
Other Defense Organizations General Funds	97		$74,833		$2,810
Other Defense Organizations Working Capital Funds	97-4930		$112,389		
Army Working Capital Fund	97-4930.001		$751		$492
Navy Working Capital Fund	97-4930.002		$446		
Air Force Working Capital Fund	97-4930.003		$59,825		$347,383
Totals:		**44,259,788**	**394,511**	**1,088**	**351,706**

General Funds Required Supplementary Information

DoD Intra-governmental Entity Liabilities ($ Amounts in Thousands)	Treasury Index	Accounts Payable	Debts/ Borrowings from Other Agencies	Other
Department of Commerce	13			$1,315
Department of the Interior	14			$4,752
Department of Justice	15			$11,205
Department of Labor	16			$330,596
Navy General Fund	17	$78,359		$5,164
United States Postal Service	18			$1
Department of the Treasury	20			$1,639,680
Army General Fund	21	$48,022		$219
Office of Personnel Management	24	($2,043)		$32,198
Department of Transportation	69			$52,471
National Aeronautics and Space Administration	80			$23,003
Department of Energy	89			$6,903
US Army Corps of Engineers	96	$232		
Other Defense Organizations General Funds	97	$40,178	$108	$18,087
Other Defense Organizations Working Capital Funds	97-4930	$183,116		$131,563
Army Working Capital Fund	97-4930.001	$1,357		
Navy Working Capital Fund	97-4930.002	$42,863		
Air Force Working Capital Fund	97-4930.003	$348,502		$10
Totals:		**$740,586**	**$108**	**$2,257,167**

DoD Intra-governmental Revenue and Related Costs ($ Amounts in Thousands)	Treasury Index	Earned Revenue
Executive Office of the President	11	$6,873
Department of Agriculture	12	$7,436
Department of Commerce	13	$5,029
Department of the Interior	14	$187
Department of Justice	15	$18,916
Navy General Fund	17	$188,910
United States Postal Service	18	$281
Department of State	19	$2,680
Department of the Treasury	20	$4,415
Army General Fund	21	$185,166
Office of Personnel Management	24	$21
Social Security Administration	28	$97
Department of Veterans Affairs	36	$684
General Service Administration	47	$2,722
National Science Foundation	49	$38,312
Federal Emergency Management Agency	58	$322
Environmental Protection Agency	68	$660
Department of Transportation	69	$49,904
Agency for International Development	72	$10,902
Department of Health and Human Services	75	$484
National Aeronautics and Space Administration	80	$81,719
Department of Energy	89	$28,068
Department of Education	91	$292
US Army Corps of Engineers	96	$532
Other Defense Organizations General Funds	97	$774,029
Other Defense Organizations Working Capital Funds	97-4930	$511,123
Army Working Capital Fund	97-4930.001	$1,320
Navy Working Capital Fund	97-4930.002	$10,251
Air Force Working Capital Fund	97-4930.003	$279,701
Totals:		**$2,211,036**

DoD Intra-governmental Non-exchange Revenues. (Amounts in Thousands)	Treasury Index	Transfers In	Transfers Out
Navy General Fund	17	$325	
Army General Fund	21		$17,741
Other Defense Organizations General Funds	97	$50,000	
Other Defense Organizations Working Capital Funds	97-4930	$423,676	
Totals:		**$474,001**	**$17,741**

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General Funds

Audit Opinions

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

February 21, 2001

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)

SUBJECT: Endorsement of the Disclaimers of Opinion on the FYs 2001 and 2000 Department of the Air Force General Fund Financial Statements (Project No. D2001FD-0112)

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General. We delegated to the Air Force Audit Agency (AFAA) the audit of the FYs 2001 and 2000 Air Force General Fund Financial Statements.[1] We contracted with KPMG LLP, an independent certified public accounting firm, to audit the FY 2001 Air Force General Fund Statement of Budgetary Resources. Summarized as follows are the AFAA and KPMG disclaimers of opinion on the FYs 2001 and 2000 Department of the Air Force General Fund Financial Statements and the results of our reviews of the AFAA and KPMG audits. The information provided in this memorandum contains reasons for the AFAA and KPMG disclaimers. We endorse the disclaimers of opinion expressed by AFAA, dated February 8, 2002, and KPMG, dated January 31, 2002.

For FY 2001, Office of Management and Budget policy required that the financial statements, except for the Statement of Budgetary Resources, be prepared on a consolidated basis. Consolidation means that intra-agency transactions are to be eliminated. The Statement of Budgetary Resources was required to be prepared on a combined basis. Combination means that component figures are added without eliminating intra-agency transactions. In addition, Office of Management and Budget policy required that the current fiscal year financial statements be presented on a comparative basis with financial statements of the previous fiscal year. Accordingly, the AFAA report covers FYs 2001 and 2000. However, we engaged KPMG LLP to audit only the FY 2001 Statement of Budgetary Resources. The KPMG report addresses only FY 2001.

Disclaimers of Opinion. The AFAA disclaimer of opinion on the FYs 2001 and 2000 Department of the Air Force General Fund Financial Statements, except for the Statement of Budgetary Resources, dated February 8, 2002, states that AFAA was unable to express an opinion on the financial statements (Attachment 1). The KPMG disclaimer of opinion on the FY 2001 Department of the Air Force General Fund Statement of Budgetary Resources, dated January 31, 2002, states that KPMG was unable to express an opinion on the financial statement (Attachment 2). We concur with the AFAA and KPMG disclaimers of opinion. The following deficiencies identified by the Department of the Air Force in the notes to the financial statements preclude an audit opinion.

[1]On January 25, 2002, the General Accounting Office issued a new Government Auditing Standard on organizational independence. The new standard is to be applied on a prospective basis and does not affect the audit work that was ongoing for the FY 2001 financial statements. We will apply the new standard for future audit work and will not delegate the financial statement audit work.

- The Air Force did not implement the U.S. Government Standard General Ledger at the transaction level.
- The Air Force is unable to implement fully all elements of generally accepted accounting principles for Federal entities (Federal GAAP) and the Office of Management and Budget Bulletin 01-09, "Form and Content of Agency Financial Statements," due to limitations in the financial management processes and systems, including nonfinancial feeder systems and processes.
- The Air Force generally records transactions on a budgetary basis and not on an accrual basis as required by Federal GAAP. For FY 2001, the Air Force's financial management systems were unable to meet all requirements for full accrual accounting.
- The Air Force could not accurately identify all intragovernmental transactions by customer.
- The Air Force does not recognize an allowance for uncollectible amounts from another Federal agency.
- The Air Force valued operating. material and supplies at standard purchase price instead of historical cost as required by Federal GAAP.

Internal Controls. The AFAA and KPMG did not express opinions on internal controls. However, AFAA identified the following material control weaknesses. Air Force Systems Support Group functional analysts made adjusting journal entries to Air Force, Air Force Reserve, and Air National Guard real property records that were not properly supported. Also, the Air Force incorrectly recorded locally purchased equipment costs in the Air Force Equipment Management System, causing a misstated general property, plant, and equipment account balance.

Compliance With Laws and Regulations. The AFAA and KPMG did not express opinions on compliance with laws and regulations. However, AFAA concluded that Air Force and Defense Finance and Accounting Service systems and controls did not achieve full compliance with applicable laws and regulations that could have a direct and material effect on the FYs 2001 and 2000 Air Force Financial Statements. Under the Federal Financial Management Improvement Act of 1996, the AFAA work showed that financial management systems did not substantially comply with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. Details on the adequacy of internal controls and compliance with laws and regulations are discussed in the AFAA report.

Review of Audit Work. To fulfill our responsibilities for determining the accuracy and completeness of the independent audit work that AFAA conducted, we reviewed the audit approach, planning, and the summary working papers that supported their conclusions. We found no indication that we could not rely on the AFAA disclaimer of opinion. To fulfill our responsibilities for determining the accuracy and completeness of the independent audit work that KPMG conducted, we evaluated the audit approach, planning, and key judgments, met with the partner and staff members, reviewed summary working papers supporting the disclaimer of opinion, and performed other procedures we deemed appropriate in the circumstances. We found no indication that we could not rely on the KPMG disclaimer of opinion.

Thomas F. Gimble
Acting
Deputy Assistant Inspector General
for Auditing

DEPARTMENT OF THE AIR FORCE
WASHINGTON DC 20330-1000

OFFICE OF THE SECRETARY

8 February 2002

To the Secretary of the Air Force
Chief of Staff, USAF

With the exception of the Statement of Budgetary Resources for Fiscal Year (FY) 2001, we were engaged to audit the accompanying Air Force General Fund financial statements for the FYs ended 30 September 2000 and 2001.[1] The accounting firm of KPMG LLP was engaged to audit the Statement of Budgetary Resources. The annual financial statements consist of the Balance Sheet and the related Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, and Statement of Financing. Preparing these financial statements is the responsibility of the Defense Finance and Accounting Service (DFAS) and Air Force management. This report presents our opinion on the financial statements, evaluation on the effectiveness of internal controls over financial reporting, and assessment of compliance with laws and regulations.

OPINION ON THE FINANCIAL STATEMENTS

We are unable to express, and we do not express, an opinion on the Air Force Balance Sheet or the Statements of Net Cost, Changes in Net Position, and Financing for the FYs ended 30 September 2000 and 2001. We were unable to obtain sufficient, competent evidential matter, or apply other auditing procedures, to satisfy ourselves as to the fairness of these statements under provisions of the Government Auditing Standards and Office of Management and Budget (OMB) Bulletin 01-02, *Audit Requirements for Federal Financial Statements*, 16 October 2000. Material uncertainties exist regarding the reasonableness of amounts reported on these statements. Air Force management has disclosed many of these uncertainties in the financial statement notes as compliance or data problems. For example:

- The DFAS has not fully implemented the U.S. Government Standard General Ledger and many of the accounting systems and Air Force non-accounting feeder systems and processes do not collect and report accounting information required by federal accounting standards.[2] (Financial Statement Note 1)
- The Air Force does not accumulate cost information as required by federal accounting standards. (Financial Statement Note 1)

[1] Management presented consolidated comparative FYs 2000 and 2001 financial statements as of 30 September 2001. Consequently, in accordance with Government Auditing Standards, our review covered the periods presented.

[2] The American Institute of Certified Public Accountants recognizes the Statements of Federal Financial Accounting Standards, developed by the Federal Accounting Standards Advisory Board and issued by the Office of Management and Budget, as generally accepted accounting principles for federal government agencies.

- The Air Force interacts with the federal government as a whole; however, the financial statements do not reflect the results of all accounting transactions applicable to the Air Force as though the Agency were a stand-alone entity. (Financial Statement Note 1)

- The DFAS and the Air Force cannot accurately identify all intragovernmental transactions by customer and, therefore, cannot be sure transactions occurring between entities within DoD, or between two or more federal agencies, are eliminated. (Financial Statement Note 1)

- The Air Force is unable to reconcile intragovernmental accounts receivable or accounts payable balances, or reconcile intragovernmental revenue balances with its trading partners. (Financial Statement Notes 5, 12, and 19)

- The balances reported by DFAS for operating materials and supplies are not recorded in conformance with federal accounting standards. Instead of recording operating materials and supplies at historical cost, the Air Force uses standard price to value its inventory without computing unrealized holding gains or losses. Further, the Air Force does not fully use the consumption method in accounting for this property. (Financial Statement Note 9)

- The Air Force generally records transactions on a cash basis and not on an accrual basis as required by generally accepted accounting principles. (Financial Statement Note 19)

Our disclaimer is also based on our inability to reconcile or validate $1.6 billion of $2.6 billion in reported construction-in-progress because Army Corps of Engineers and Naval Facilities Engineering Command supporting documentation was not timely received, and project costs were not identified to allow audit testing. Furthermore, while the Air Force provided input, the DoD did not publish the FY 2001 Financial Management Improvement Plan in time for us to determine if known Air Force and DFAS financial system weaknesses were included and remediation plans established.

REQUIRED SUPPLEMENTARY INFORMATION

The Required Supplementary Information is not a required part of the principal financial statements, but is supplementary information required by OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*, 25 September 2001. We did not audit the Required Supplementary Information and, therefore, express no opinion on the information.

The Required Supplementary Stewardship Information is not a required part of the principal statements and, therefore, is not required to be audited. However, the OMB still requires Required Supplementary Stewardship Information to be reported, including national defense property, plant, and equipment. As instructed by DoD, the Air Force did not report this information. While we selectively reviewed additions and deletions to National Defense Property, Plant, and Equipment records, we express no opinion on the Required Supplementary Stewardship Information.

MANAGEMENT ACTIONS

During the past several years, the Office of the Under Secretary of Defense (Comptroller/Chief Financial Officer) initiated several strategies designed to produce auditable financial statements and improve financial data accuracy and reporting. The DFAS and Air Force continue to support those initiatives. To illustrate:

- During FY 2001, DoD established the financial management modernization initiatives, of which the Assistant Secretary of the Air Force (Financial Management & Comptroller) is a member. The purpose of this initiative is to establish a DoD Program Management Office to document the current and future DoD financial management systems architecture. The Air

Force is in the process of supplying critical feeder system and other feeder system information. DoD anticipates completion of this phase of the initiative in FY 2002.

- To comply with federal accounting standards, the Air Force continues to implement the consumption method of accounting and moving average valuation for operating materials and supplies. In addition, in FY 2001 the Federal Accounting Standards Advisory Board proposed amending the definition for National Defense Property, Plant, and Equipment. The Air Force interprets these changes as directly affecting some items previously reported as property, plant, and equipment and categorizes these assets as supplies to be accounted for according to Statement of Federal Financial Accounting Standard (SFFAS) No. 3, *Accounting for Inventory and Related Property*. The Office of the Under Secretary of Defense (Comptroller), in concert with the Services, has contracted a study to review the Services' strategies for accurately defining, classifying, and reporting National Defense Property, Plant, and Equipment.

- In FY 2001, to comply with SFFAS No. 10, *Accounting for Internal Use Software*, the Air Force began an effort to identify and account for internal use software and report those assets on the financial statements. Managers established definitions, software development plans, data sources, and a reporting mechanism to report $28 million in software assets. The Air Force will continue this effort in FY 2002.

- The Air Force continued to develop the Total Ownership Cost management information system in FY 2001. This system analyzes myriad standard system data to provide detailed information on weapon system costs. Also, the Commanders' Resource Integration System will provide data warehouse information storage and analysis, and performs flying hour program analysis. The Air Force plans to merge these two systems to create an overall Air Force Central Cost Data Warehouse.

- We believe these efforts will help resolve many existing problems with systems and financial reporting. We will work closely with management to address material deficiencies that preclude an unqualified audit opinion.

REPORT ON INTERNAL CONTROLS

Management is responsible for establishing and maintaining an internal control structure to provide reasonable, but not absolute, assurance that transactions are properly recorded, processed, and summarized for financial statement preparation in accordance with standards, and for safeguarding assets against loss from unauthorized use. Because of inherent limitations in any system of internal controls, errors or fraud may not be detected. Also, internal controls in future periods may become inadequate. As a result, our consideration of internal controls may not necessarily disclose all material weaknesses. A material weakness is a condition where controls do not reduce to a relatively low level, the risk that errors or irregularities, in amounts that would be material in relation to the financial statements, may occur and not be detected within a timely period by employees performing their assigned functions.

Although we accomplished internal control testing, our financial statement audit objectives did not include providing a separate internal control opinion. Accordingly, we do not express such an opinion. However, OMB Bulletin 01-02 requires that we describe reportable conditions and material weaknesses identified during the audit. Accordingly, the following paragraphs summarize material weaknesses and reportable conditions that existed in the design or operation of the internal control structure over financial reporting in effect at 30 September 2001 for the Air Force consolidated financial statements. These weaknesses, along with recommended remedial actions and time frames for corrective actions, are more fully described in supporting audit reports issued to Air Force and DFAS management.

REAL PROPERTY ADJUSTING JOURNAL ENTRIES

Air Force Systems Support Group functional analysts made adjusting journal entries to Air Force, Air Force Reserve, and Air National Guard real property records that were not properly supported. Analysts made these entries to correct imbalances between Automated Civil Engineer System facility inventory data and general ledger account balances. Because the entries were not processed at facility level, we could not verify the propriety of the transactions by tracing them to individual facilities. As a result, we could not confirm the validity of $11.8 billion of adjusting journal entries included in the Property, Plant, and Equipment line item on the Balance Sheet. While this is a substantial improvement over the $31.1 billion identified in our FY 2000 audit, the conditions causing this problem continue and should be reported as a material weakness. The Air Force did not include this issue in their FY 2001 Statement of Assurance. (AFAA Project F2001-B05300-0023, Accounting for Air Force Real Property)

ELECTRONIC SYSTEMS INTERFACE

The Air Force incorrectly recorded locally purchased equipment costs in the Air Force Equipment Management System, causing a misstated general property, plant, and equipment account balance. This condition occurred because the electronic interface between the Standard Base Supply System, which records purchase and receipt of assets, and the Air Force Equipment Management System, which maintains asset inventory and depreciation records, did not accurately transfer asset costs. Specifically, the data element to track asset unit values in the supply system is 10 digits versus 7 digits in the Equipment Management System. As a result, the value of assets with unit costs of $10 million or more was understated on the Balance Sheet by $190 million. (AFAA Project F2001-B05300-0031, Accounting for Property, Plant, and Equipment – Personal Property)

PERFORMANCE MEASURES

Our limited review of internal controls related to performance measures, reported in the Management Discussion and Analysis section of the principal statements, did not identify any control weaknesses. Because we only obtained an understanding of the sources and controls related to performance measures, our work was not intended to determine whether controls were in place and working as designed. However, we concluded the information presented in the Management Discussion and Analysis section was materially consistent with the financial statements and footnotes.

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

Air Force management is responsible for complying with applicable laws and regulations. Issues that should concern management include compliance with laws and regulations pertaining to the objectives of Air Force General Fund programs, and the activities, functions, and manner in which programs and services are delivered. Material instances of noncompliance are failures to follow requirements or violations of laws or regulations that make us conclude the misstatements resulting from these violations are material to the financial statements, or the sensitivity of the matter would cause others to perceive the misstatements as significant. To obtain reasonable assurance that financial statements are free of material misstatement, we tested compliance with laws and regulations where noncompliance could have a direct and material effect on financial statement amounts, to include requirements contained in the Federal Financial Management Improvement Act (FFMIA) and Federal Managers' Financial Integrity Act (FMFIA). We concluded Air Force and DFAS systems and controls did not achieve full compliance with applicable laws and regulations that could have a direct and material effect on the FY 2001 Air Force financial statements. We considered noncompliance issues discussed below in forming our opinion on the financial statements. Our audit objectives did not include providing a separate opinion on overall compliance with laws and regulations and, accordingly, we do not express such an opinion.

FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT

The FFMIA requires report disclosure on whether Air Force financial management systems substantially comply with federal financial management system requirements, federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. Our audit tests disclosed instances where Air Force or DFAS systems did not substantially comply with the three FFMIA requirements.

a. Federal Financial Management System Requirements. In their FY 2001 Statement of Assurance, DFAS-Denver reported that journal vouchers were not supported due to DoD system weaknesses. Specifically, transactions are manually posted rather than processed by automated accounting systems to a general ledger account or a formal record of original entry from the original source document. As a result, journal vouchers were not always supported or documented. In addition, accounting systems do not capture trading partner data at the transaction level to facilitate eliminations, and intragovernmental accounts receivable and accounts payable balances cannot be reconciled. Also, the Air Force cannot reconcile revenue balances with its trading partners and states that the volume of intragovernmental transactions is too large for an after-the-fact reconciliation. The Air Force reported consolidated intragovernmental accounts receivable of $394 million and accounts payable of $741 million.

b. Federal Accounting Standards. Air Force management acknowledged in FY 2001 that its financial management systems did not allow substantial compliance with federal accounting standards. Specifically, financial statement footnotes disclosed the following areas of noncompliance.

- The Air Force and DFAS identify costs in the Statement of Net Cost based upon the major appropriation groups funded by Congress instead of specific programs and activities as set forth in SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*;
- The Air Force does not record operating materials and supplies balances derived from logistics systems in conformance with SFFAS No. 3. Instead of recording operating materials and supplies at historical cost, the Air Force uses standard price to value its inventory without computing unrealized holding gains and losses;
- The Air Force and DFAS do not fully use the consumption method of accounting for operating materials and supplies in compliance with SFFAS No. 3; and
- The Air Force and DFAS generally record transactions on a cash basis instead of the accrual basis as required by generally accepted accounting principles which affects the amounts presented in the Statement of Net Cost. Further, not all government furnished material and material in the hands of contractors is included in the operating materials and supplies balances.

c. Standard General Ledger. As disclosed in the financial statement footnotes, DFAS managers had not implemented the U.S. Government Standard General Ledger. Lacking a transaction-driven general ledger process, managers extracted data from multiple automated and manual systems, many of which were outside the accounting and finance network, to derive account balances. This process significantly increased the potential for account balance misstatements.

FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT

Air Force management acknowledged in the FY 2001 Statement of Assurance and in the Management Discussion and Analysis section of the financial statements that Air Force systems do not fully comply with federal financial management system requirements. Both of these documents describe actions underway to bring systems into conformance with requirements. Because the FY 2001 DoD Financial Management Improvement Plan was not yet published, we could not confirm that all system deficiencies were reported, along with remediation plans. We did confirm, however, material control weaknesses disclosed in our audit reports, except as cited above, were reported in Air Force or DFAS-DE FY 2001 Statements of Assurance.

OBJECTIVE, SCOPE, AND METHODOLOGY

Management responsibilities are to:

- Prepare the annual financial statements in conformity with applicable accounting principles.
- Establish and maintain internal controls and systems to provide reasonable assurance that the broad control objectives of the FMFIA are met.
- Implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level.
- Comply with other applicable laws and regulations.

AFAA responsibilities are to:

- Plan and perform an audit to obtain reasonable assurance about whether the principal financial statements are reliable (free of material misstatement) and presented fairly in conformity with OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*, and applicable accounting principles.
- Obtain reasonable assurance about whether relevant management internal controls are in place and operating effectively.
- Test management compliance with selected provisions of laws and regulations and perform limited procedures to test the consistency of other information presented with the financial statements.

To fulfill these responsibilities, we:

- Examined, on a test basis, evidence supporting the amounts and disclosures in the principal financial statements.
- Assessed the accounting principles used and significant management estimates.
- Evaluated the overall presentation of the financial statements.
- Tested compliance with selected provisions of laws and regulations.
- Obtained an understanding of the design of internal controls, determined whether they had been placed in operation, assessed control risk, and obtained sufficient evidence from our tests to support our assessment of internal controls.

- Selectively tested evidence supporting additions, deletions, and disclosures in the Required Supplementary Stewardship Information.

- Followed up on previously reported deficiencies.

In reviewing the Air Force consolidated financial statements, we evaluated internal controls to determine the reliability of financial and performance reporting related to the principal statements, accompanying footnotes, and the Overview of the Reporting Entity, including performance measures. In the area of financial reporting, we determined whether Air Force and DFAS personnel properly recorded, processed, and summarized transactions to permit financial statement preparation in accordance with federal accounting standards. We also (1) evaluated the safeguarding of assets against loss from unauthorized use or disposition; (2) obtained an understanding of the design of internal controls; (3) determined whether the controls were in operation; (4) assessed control risk; and (5) tested the controls.

With respect to information in the Overview of the Reporting Entity, we determined whether the information presented was materially consistent with the information presented in the principal statements and accompanying footnotes. In the area of performance measures, we obtained an understanding of the sources and controls related to performance measures in the overview accompanying the Air Force consolidated financial statements. We obtained an understanding of the design of internal controls related to the existence and completeness assertions. We accomplished the audit at the Office of the Assistant Secretary of the Air Force, Financial Management and Comptroller; DFAS locations (DFAS centers and DFAS field sites); HQ Air Force Materiel Command; and Air Force active duty units. Specific locations are listed in the individual audit reports. We completed audit fieldwork in December 2001 and provided a draft report to management in January 2002.

SUMMARY OF PRIOR AUDIT COVERAGE

The DoD Inspector General, GAO, and the AFAA have conducted multiple reviews related to financial management issues. Last year, we issued a disclaimer on the FY 2000 Air Force consolidated financial statements. The DoD Inspector General reports can be accessed over the Internet at http://www.dodig.osd.mil; the GAO reports can be accessed at http://www.gao.gov; and AFAA reports, at http://www.afaa.hq.af.mil.

We appreciate the cooperation and courtesies extended to our auditors.

Earl J Scott

EARL J. SCOTT
The Deputy Auditor General

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2001 M. Street, NW
Washington, DC 20036

INDEPENDENT AUDITORS' REPORT

Secretary of the Air Force and
Office of Inspector General, Department of Defense:

Report on the Combined Statement of Budgetary Resources

We were engaged to audit the accompanying combined General Fund statement of budgetary resources of the United States Air Force (Air Force) for the year ended September 30, 2001. This financial statement is the responsibility of the management of the Air Force.

The Air Force was unable to make available for audit all records and related data, including the management representation letter, on a timely basis. As such, we were unable to complete our audit procedures by the date specified under the terms of our engagement.

Because of the matters discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying combined General Fund statement of budgetary resources of the United States Air Force, for the year ended September 30, 2001.

The information in the required supplementary information section is not a required part of the financial statement, but is supplementary information required by the Federal Accounting Standards Advisory Board or Office of Management and Budget (OMB) Bulletin No. 97-01, Form and Content of Agency Financial Statements, as amended, as it relates to the combined General Fund statement of budgetary resources. Because of the matters discussed in the second paragraph, we were unable to apply certain limited procedures which would have consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. Therefore, we express no opinion on it and cannot comment on its measurement or presentation.

The combining information on the combining General Fund statement of budgetary resources is presented for purposes of additional analysis of the combined statement rather than to present the budgetary resources of the Air Force Active, Air Force Reserve and Air National Guard, individually. Because of matters discussed in the second paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the combining General Fund statement of budgetary resources in relation to the combined statement taken as a whole.

Internal Control over Financial Reporting and Compliance With Laws and Regulations

In connection with our engagement, we were also engaged to consider the Air Force's internal control over financial reporting as it related to the combined General Fund statement of budgetary resources and to test the Air Force's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on its combined statement of budgetary resources.

General Funds

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Air Force's ability to record, process, summarize, and report financial data consistent with the assertions by management in the combined General Fund statement of budgetary resources.

Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the financial statement being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal control, misstatements, due to error or fraud may nevertheless occur and not be detected.

The Air Force was unable to make available for audit all records and related data, including the management representation letter, on a timely basis. As such, we were unable to complete our audit procedures by the date specified under the terms of our engagement. Therefore, the scope of our work was not sufficient to enable us to report on matters involving internal control over financial reporting related to the combined General Fund statement of budgetary resources and its operation that may be considered reportable conditions and material weaknesses, and accordingly, we do not report on those matters.

In addition, because of the matters discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to complete our tests of compliance with laws and regulations that could have a direct and material effect on the combined General Fund statement of budgetary resources, as required under *Government Auditing Standards* and OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, or on the requirements of the Federal Financial Management Improvement Act of 1986 (FFMIA) relating to (1) Federal management system requirements, (2) applicable Federal accounting standards, and (3) the U.S. Government Standard General Ledger at the transaction level. Therefore, the scope of work was not sufficient to able us to report on whether the Air Force's financial management systems complied with applicable laws and regulations or with the three requirements of FFMIA described above, and accordingly, we do not report on those matters.

Distribution

This report is intended for the information and use of Air Force's management, the Department of Defense Office of the Inspector General, OMB and the U.S. Congress, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

January 31, 2002

Combined General Funds Statement of Budgetary Resources

United States Air Force

For the year ended September 30, 2001 ($ in Thousands)

BUDGETARY RESOURCES	
Budget Authority	$ 92,717,301
Unobligated Balance—Beginning of Period	7,105,052
Net Transfers Prior-Year Balance, Actual	(2,130,103)
Spending Authority from Offsetting Collections	5,211,233
Adjustments	(724,271)
Total Budgetary Resources	$ 102,179,212
STATUS OF BUDGETARY RESOURCES	
Obligations Incurred	$ 94,975,926
Unobligated Balances—Available	6,370,402
Unobligated Balances—Not Available	832,884
Total, Status of Budgetary Resources	$ 102,179,212
OUTLAYS	
Obligations Incurred	$ 94,975,926
Less: Spending Authority from Offsetting Collections and Adjustments	(6,483,355)
Obligated Balance, Net—Beginning of Period	33,410,761
Less: Obligated Balance, Net—End of Period	(37,049,173)
Total Outlays	$ 84,854,159

The accompanying notes are an integral part of this statement.

Note 1. Significant Accounting Policies

1.A. Reporting Entity

The National Security Act of 1947 created the Air Force on September 18, 1947. The National Security Act Amendments of 1949 established the Department of Defense (DoD) and made the Air Force a department within DoD. The overall mission of the Air Force is to defend the United States and protect its interest through air and space power.

1.B. Basis of Presentation

The combined General Fund statement of budgetary resources (the Statement) has been prepared to report the budgetary resources of the United States Air Force's General Fund. The Statement was prepared from the books and records of the Air Force in accordance with generally accepted accounting principles applicable to federal entities. The Statement includes Air Force activities financed by General Funds. General Funds are used to record financial transactions arising under congressional appropriations. The Air Force manages sixteen general fund accounts, consisting of seven funded by annual year appropriations and nine funded with multiple year appropriations.

1.C. Basis of Accounting

The Air Force records transactions on a budgetary basis of accounting. Budgetary accounting is accomplished through unique accounts to facilitate compliance with legal and internal control requirements associated with the use of federal funds.

The Statement has been prepared from the accounting records in conformity with generally accepted accounting principles and the form and content for Federal entity financial statements specified by the Office of Management and Budget (OMB) in OMB Bulletin 97-01, as amended, as related to the statement of budgetary resources.

Generally accepted accounting principles for Federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board, which is the official accounting standard-setting body for the Federal. Government.

As provided by OMB Bulletin 97-01, as amended, the Statement is prepared on a combined basis; therefore, intra-entity transactions and balances have not been eliminated.

1.D. Revenues and Other Financing Sources

Financing sources for the General Fund 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 because 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 authority to obligate is recognized (i.e., obligations may be recorded) when orders from a government entity are accepted or orders accompanied by advances from a non-federal entity are received. Obligation authority must be recorded before performance on an order begins.

The appropriations used to fund, execute and report on total financial activity of the General Fund includes operations, investment (procurement) and research, development, test and evaluation (RDT&E).

a. Operation accounts represent those funds used for the pay of operating forces. These funds also finance the functional and administrative support needed to operate and maintain Air Force installations.

b. Investment (procurement) accounts are used for specific purposes that are approved by and reportable to Congress. These accounts are used for the acquisition of technology, property, and infrastructures.

c. The Air Force conducts and contracts for RDT&E of advance weapon systems. The RDT&E programs support modernization of weapon systems through military research, exploratory development, and the development and testing of prototypes and full-scale pre-production hardware.

1.E. Accounting for Intragovernmental Activities

Transactions between the Air Force and other entities within DoD or with another Federal agency are intragovernmental transactions. The Air Force cannot identify all intergovernmental transactions by customer, and as such, as permitted by OMB Bulletin 97-01, the Statement is prepared on a combined basis without elimination of intragovernmental transactions.

1.F. Accounts Receivable

Spending Authority from Offsetting Collections and Obligation Balances, Net includes accounts and claims from other federal entities and from the public. Claims against another Federal agency are to be resolved between the agencies.

1.G. Undelivered Orders

The Air Force records obligations for goods and services that have been ordered but not received.

1.H. Canceled Balances

All unliquidated balances associated with closed accounts were canceled in accordance with Public Law 101-510.

Note 2. Disclosures Related to the Statement of Budgetary Resources

As of September 30, 2001, the Air Force had undelivered orders totaling $32 billion. Undelivered orders include unexpended obligations for both appropriated and reimbursable funds. Undelivered orders are included in Obligations Incurred on the Statement.

The Statement does not include any amounts for which the United States Department of Treasury is willing to accept corrections to canceled appropriation amounts. Negative budgetary resources of $89 million (relating to offsetting receipts of Accounts included on the Report on Budget Execution, or the Standard Form 133) are not included in the Statement.

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 Statement), are not included in Spending Authority from Offsetting Collections and Adjustments line of the Statement.

The Schedule of General Fund Budgetary Resources by Major Budget Account, included as required supplementary information includes an amount in the Unobligated Balances – Not Available in the Research, Development, Test, & Evaluation account that relates to the cancellation of reimbursable authority at fiscal year end.

Note 3. Suspense and Budget Clearing Accounts

As of September 30, 2001, balances in the suspense and budget clearing accounts are as follows:

Account		
F3875	$	9,579
F3880	$	(1,514)
F3885	$	494,240
F3886	$	5
Total	$	502,310

The Air Force has made a concerted effort to reduce balances in the suspense and budget clearing accounts, and to establish an accurate and consistent use of these accounts.

On September 30 of each fiscal year, all of the uncleared suspense and budget clearing account balances are reduced to zero by transferring the balances to proper appropriation accounts using a logical methodology, such as prorating the amounts on a percentage basis derived by comparing the disbursements in the suspense and clearing account to total disbursements.

Combining General Funds Statement of Budgetary Resources

United States Air Force

For the year ended September 30, 2001 ($ in Thousands)

	Air Force Active	Air Force Reserve	Air National Guard	Combined Total
BUDGETARY RESOURCES				
Budget Authority	$ 84,339,994	$ 2,929,900	$ 5,447,407	$ 92,717,301
Unobligated Balance—Beginning of Period	6,804,101	104,486	196,465	7,105,052
Net Transfers Prior-Year Balance, Actual	(2,262,070)	43,974	87,993	(2,130,103)
Spending Authority from Offsetting Collections	4,893,575	47,733	269,925	5,211,233
Adjustments	(727,333)	3,044	18	(724,271)
Total Budgetary Resources	$ 93,048,267	$ 3,129,137	$ 6,001,808	$ 102,179,212
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred	86,173,544	3,012,250	5,790,132	94,975,926
Unobligated Balances—Available	6,205,419	23,572	141,411	6,370,402
Unobligated Balances—Not Available	669,304	93,315	70,265	832,884
Total, Status of Budgetary Resources	$ 93,048,267	$ 3,129,137	$ 6,001,808	$ 102,179,212
OUTLAYS				
Obligations Incurred	$ 86,173,544	$ 3,012,250	$ 5,790,132	$ 94,975,926
Less: Spending Authority from Offsetting Collections and Adjustments	(6,092,981)	(74,906)	(315,468)	(6,483,355)
Obligated Balance, Net—Beginning of Period	31,776,000	648,595	986,166	33,410,761
Less: Obligated Balance, Net—End of Period	(35,455,895)	(540,801)	(1,052,477)	(37,049,173)
Total Outlays	$ 76,400,668	$ 3,045,138	$ 5,408,353	$ 84,854,159

Required Supplementary Information

Schedule of General Funds Budgetary Resources by Major Budget Account

United States Air Force

For the year ended September 30, 2001 ($ in Thousands)

	Military Personnel	Operation and Maintenance	Procurement
BUDGETARY RESOURCES			
Budget Authority	$ 20,955,776	$ 30,226,589	$ 25,626,542
Unobligated Balance—Beginning of Period	270,534	786,695	3,520,194
Net Transfers Prior-Year Balance, Actual	48,764	607,489	(2,754,778)
Spending Authority from Offsetting Collections	213,442	3,030,597	108,638
Adjustments	(83,540)	239,316	(690,798)
Total Budgetary Resources	$ 21,404,976	$ 34,890,686	$ 25,809,798
STATUS OF BUDGETARY RESOURCES			
Obligations Incurred	$ 21,240,098	$ 34,233,552	$ 21,657,735
Unobligated Balances—Available	18,580	70,708	4,050,764
Unobligated Balances—Not Available	146,298	586,426	101,299
Total, Status of Budgetary Resources	$ 21,404,976	$ 34,890,686	$ 25,809,798
OUTLAYS			
Obligations Incurred	$ 21,240,098	$ 34,233,552	$ 21,657,734
Less: Spending Authority from Offsetting Collections and Adjustments	(257,859)	(3,675,349)	(524,721)
Obligated Balance, Net—Beginning of Period	675,050	9,204,712	16,284,091
Less: Obligated Balance, Net—End of Period	(1,749,314)	(9,624,981)	(18,182,537)
Total Outlays	$ 19,907,975	$ 30,137,934	$ 19,234,567

	Research, Development, Test & Evaluation	Military Construction/ Family Housing	Other	Total Combined
	$ 14,509,655	$ 1,391,310	$ 7,429	$ 92,717,301
	2,068,588	455,640	3,403	7,105,052
	(17,943)	(13,635)	0	(2,130,103)
	1,841,066	1,190	16,299	5,211,233
	(204,239)	15,818	(828)	(724,271)
	$ 18,197,127	$ 1,850,323	$ 26,303	$ 102,179,212
	$ 16,479,739	$ 1,341,245	$ 23,557	$ 94,975,926
	1,741,774	485,831	2,746	6,370,402
	(24,386)	23,247	0	832,884
	$ 18,197,127	$ 1,850,323	$ 26,303	$ 102,179,212
	$ 16,479,739	$ 1,341,245	$ 23,557	$ 94,975,926
	(1,976,306)	(32,820)	(16,299)	(6,483,355)
	5,533,339	1,712,467	1,102	33,410,761
	(5,760,646)	(1,726,258)	(5,436)	(37,049,173)
	$ 14,276,126	$ 1,294,634	$ 2,924	$ 84,854,159

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Working Capital Fund

Principal Statements

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Consolidated Balance Sheet—Working Capital Fund

As of September 30 ($ in Thousands)

		FY 2001		FY 2000
ASSETS *(Note 2)*				
Intragovernmental:				
Fund Balance with Treasury *(Note 3)*	$	556,603	$	214,627
Accounts Receivable *(Note 5)*		461,229		729,449
Other Assets *(Note 6)*		57,320		65,592
Total Intragovernmental Assets	$	1,075,152	$	1,009,668
Cash and Other Monetary Assets *(Note 7)*	$	0	$	102
Accounts Receivable *(Note 5)*		105,290		73,578
Inventory and Related Property *(Note 9)*		11,056,384		17,310,658
General Property, Plant and Equipment *(Note 10)*		1,258,047		1,255,368
Other Assets *(Note 6)*		468,474		790,490
TOTAL ASSETS	$	13,963,347	$	20,439,864
LIABILITIES *(Note 11)*				
Intragovernmental:				
Accounts Payable *(Note 12)*	$	143,833	$	192,597
Other Liabilities *(Note 15 & Note 16)*		353,537		25,379
Total Intragovernmental Liabilities	$	497,370	$	217,976
Accounts Payable *(Note 12)*	$	1,328,019	$	201,906
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities *(Note 17)*		242,137		198,890
Other Liabilities *(Note 15 & Note 16)*		3,111,789		3,346,456
TOTAL LIABILITIES	$	5,179,315	$	3,965,228
NET POSITION				
Unexpended Appropriations *(Note 18)*	$	0	$	63,971
Cumulative Results of Operations		8,784,032		16,410,665
TOTAL NET POSITION	$	8,784,032	$	16,474,636
TOTAL LIABILITIES AND NET POSITION	$	13,963,347	$	20,439,864

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 ($ in Thousands)

	FY 2001	FY 2000
Program Costs		
Intragovernmental	$ 6,667,495	$ 6,093,205
With the Public	9,606,407	7,256,718
Total Program Cost	$ 16,273,902	$ 13,349,923
(Less: Earned Revenue)	(11,975,321)	(11,548,149)
Net Program Costs	$ 4,298,581	$ 1,801,774
Net Cost of Operations	$ 4,298,581	$ 1,801,774

The accompanying notes are an integral part of the financial statements.
See notes 1 and 19.

Consolidated Statement of Changes in Net Position—Working Capital Fund

For the years ended September 30 ($ in Thousands)

		FY 2001		FY 2000
Net Cost of Operations	$	4,298,581	$	1,801,777
Financing Sources (other than exchange revenues)				
Appropriations Used		8,375		0
Imputed Financing *(Note 20)*		124,432		107,034
Transfers - in		71,256		229,402
Transfers - out		(41,038)		(378,445)
Other		(92,576)		389,788
Total Financing Sources (other than Exchange Revenues)	$	70,449	$	347,779
Net Results of Operations	$	(4,228,133)	$	(1,453,998)
Prior Period Adjustments *(Note 20)*		(3,462,470)		(1,419,599)
Net Change in Cumulative Results of Operations	$	(7,690,603)	$	(2,873,597)
Change in Net Position	$	(7,690,603)	$	(2,873,597)
Net Position-Beginning of the Period		16,474,636		19,348,233
Net Position-End of the Period	$	8,784,033	$	16,474,636

The accompanying notes are an integral part of the financial statements.
See notes 1 and 20.

Combined Statement of Budgetary Resources—Working Capital Fund

For the years ended September 30 ($ in Thousands)

		FY 2001		FY 2000
BUDGETARY RESOURCES				
Budget Authority	$	511,412	$	384,498
Unobligated Balance - Beginning of Period		55,601		512,188
Net Transfers Prior Year Balance, Actual		65,500		207,900
Spending Authority from Offsetting Collections		15,269,371		14,763,644
Adjustments		(8,702)		(777,284)
Total Budgetary Resources	$	15,893,182	$	15,090,946
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred	$	15,702,007	$	15,035,345
Unobligated Balances - Available		191,175		55,601
Total, Status of Budgetary Resources	$	15,893,182	$	15,090,946
OUTLAYS				
Obligations Incurred	$	15,702,007	$	15,035,345
Less: Spending Authority from Offsetting Collections and Adjustments		(15,270,670)		(14,763,644)
Obligated Balance, Net - Beginning of Period		2,791,001		2,806,547
Less: Obligated Bal, Net - End of Period		(3,490,438)		(2,791,000)
Total Outlays	$	(268,100)	$	287,247

The accompanying notes are an integral part of the financial statements.
See notes 1 and 21.

Combined Statement of Financing—Working Capital Fund

For the years ended September 30 ($ in Thousands)

		FY 2001		FY 2000
OBLIGATIONS AND NONBUDGETARY RESOURCES:				
Obligations Incurred	$	15,702,007	$	15,035,345
Less: Spending Authority from Offsetting Collections & Adjustments		(15,270,670)		(14,763,644)
Financing Imputed for Cost Subsidies		124,432		107,034
Transfers-In (Out)		(1,928)		1,092,348
Total Obligations as Adjusted and Nonbudgetary Resources	$	553,841	$	1,471,083
RESOURCES THAT DO NOT FUND NET COST OF OPERATIONS:				
Change in Amount of Goods, Services, and Benefits Ordered but not yet Received or Provided (Increases)/Decreases	$	(173,540)	$	290,667
Change in Unfilled Customer Orders		455,715		(126,261)
Costs Capitalized on the Balance Sheet - (Increases)/Decreases		3,141,138		(28,939)
Financing Sources that Fund Costs of Prior Periods		126,043		(206,522)
Total Resources That Do Not Fund Net Costs of Operations	$	3,549,356	$	(71,055)
COMPONENTS COSTS OF OPERATIONS THAT DO NOT REQUIRE/GENERATE RESOURCES:		0		0
Depreciation and Amortization	$	145,844	$	146,122
Revaluation of Assets and Liabilities - Increases/(Decreases)		3,901		0
Loss of Disposition of Assets		2,393		56,739
Total Costs That Do Not Require Resources	$	152,138	$	202,861
FINANCING SOURCES TO BE PROVIDED	$	43,246	$	198,890
NET COST OF OPERATIONS	$	4,298,581	$	1,801,779

The accompanying notes are an integral part of the financial statements.
See notes 1 and 22.

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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 (WCF), as required by the Chief Financial Officers (CFOs) 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 WCF 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. The Air Force WCF'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 Air Force WCF is unable to implement all elements of federal generally accepted accounting principles (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 Air Force WCF'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 the requirements to maintain accountability over assets and to report the status of federal appropriations rather than to reflect the current emphasis of business-like financial statements. As a result, the Air Force WCF cannot currently implement every aspect of GAAP and the OMB Bulletin No. 01-09. The Air Force WCF continues to implement process and system improvements to address the limitations of its financial and non-financial feeder systems.

There are other instances when the Air Force WCF has reviewed the intent of the standard and applied it in a manner consistent with the standard, but the auditors interpret the standard differently. Financial statement elements impacted include financing payments under fixed price contracts, operating materials and supplies (OM&S), and disposal liabilities.

The accompanying financial statements account for all resources for which the Air Force WCF is responsible except that information relative to classified assets, programs, and operations have been excluded from the statement or otherwise aggregated and reported in such a manner that it is no longer classified. Fiscal year (FY) 2001 represents the sixth year that the Department will prepare and have audited DoD Agency-wide financial statements as required by the CFO Act and GMRA.

A more detailed explanation of these financial statement elements is discussed in the applicable footnote.

1.B. Mission of the Reporting Entity

The United States Air Force was created on September 18, 1947, by the National Security Act of 1947. The National Security Act Amendments of 1949 established the Department of Defense (DoD) and made the Air Force a department within DoD. The overall mission of the Department 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. DoD established the revolving funds as a means to more effectively control the cost of work performed. 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 in the course of executing the Air Force's missions.

Revolving funds receive their initial working capital through an appropriation or a transfer of resources from existing appropriations of 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 Financial Management Regulation 7000.14-R, 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 now five active business activities in the Supply Management Activity Group (SMAG). They are: Materiel Support Division (MSD), General Support Division (GSD), Medical-Dental Division, Fuels Division (including aviation, ground, missile and cost of operations fuels), and Academy Division. Troop Support is a residual activity.

Depot Maintenance

The Air Force Depot Maintenance Activity Group 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 sources.

Transportation

The unique transportation responsibilities of 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 disestablished in FY 1995 in accordance with the DWCF improvement plan. Only residual accounting of unliquidated balances remains, with expected close-out during FY02.

Information Services

Air Force Central Design Activities

The Air force Central Design Activities (CDAs) provide software design, development, maintenance, and technical support services. As of October 1, 1995, the Air Force CDA business area transferred to DBOF. This transfer complied with Program Budgeting Document (PBD) 433 in expanding the Information Services Business Area. Transfer procedures were set forth in DFAS-Arlington memo dated May 3, 1995. The Central Design Activities included the Standard Systems Group and the Materiel Systems Group. Prior to this transfer, the CDAs were funded by Air Force Operations and Maintenance funds. During FY 1996 DFAS-Denver provided only interim accounting support because the CDAs' accounting support was in transition to the Industrial Fund Accounting System (IFAS) and subsequent transfer to the Pensacola Field Site. In FY 1997, the CDAs went on-line with IFAS and all financial reports, excluding the Audited Financial Statements (AFS), are prepared by DFAS-Cleveland and forwarded to DFAS-Denver for inclusion with Air Force WCF statements. In FY 2002, DFAS-Denver will take over the responsibility of all monthly CDAs' financial reporting and the AFS.

United States Transportation Command (USTC)

For AFS purposes only, USTC is not reported within Air Force Working Capital Funds. The Office of the Under Secretary Defense, Chief Financial Officer, directed in fiscal year 1999, the reporting of USTC with Other Defense Organizations Working Capital Fund Consolidated statements submitted by DFAS-Indianapolis. The USTC remains part of the Air Force Budget operations for all other financial reporting.

Air Force Working Capital Fund Component

The Air Force Component Activity's purpose is to act as a balancing/adjusting column for Air Force WCF. 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 dated January 21, 1997, "Operating Policy and Procedures for the Management of Defense Working Capital Funds (DWCF) Fund Balance with Treasury Management and Contract Authority," and January 28, 1997, "Entries to Establish Defense Working Capital (DWCF) Fund Balance with Treasury at the Air Force subnumbered Account Level," provided specific and detailed instructions/procedures to maintain accountability for fund balances with Treasury. Undistributed disbursements, collections, and other amounts that cannot be identified to a functional area within the respective WCF, shall be reported in this column.

Operations of the activities within the Air Force WCF 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**:

Policy and procedures have been changed to fund minor construction projects that cost $100,000 or more, but less than $300,000, through a separate section of the capital budget and depreciate them 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 will 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 depreciated/amortized over the relevant life cycle.

(5) **Asset Capitalization and Depreciation**:

The assets of the industrial and stock funds were transferred to DBOF and subsequently to WCF. The 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 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 do 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 2001, Air Force DWCF operations encompass 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 Air Force's Working Capital Funds generally record transactions on an accrual accounting basis as is required by Federal GAAP. However, some of the Air Force's financial and non-financial feeder systems and processes are not designed to collect and record financial information on the full accrual accounting basis. The Air Force has undertaken efforts to determine the required actions to bring all of its financial and non-financial feeder systems and processes into compliance with all elements of the GAAP. One such action is the current revision of its accounting systems to record transactions based on the United States Government Standard General Ledger (SGL). Until such time as all of the processes/systems are updated to collect and report financial information as required by GAAP, some of the Air Force's financial data will be based on budgetary obligations, disbursements, collections and transactions, from non-financial feeder systems. One example is the information presented on the Statement of Net Cost. Most of this information 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 balances are not materially significant. In addition to the accrual basis of accounting, Depot Maintenance also uses the full absorption accounting principal. During FY 1996, DFAS-DE, SAF/FMB, and OSD/FM jointly agreed on the use of this principal by Depot Maintenance. This 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 are 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 "crosswalked" 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 from becoming overly voluminous.

The asset accounts used to prepare the statements are categorized as either entity or nonentity. Entity accounts 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 accounts are assets that are held by an entity 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 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 point of sale under constructive delivery terms (normally when an item is released from inventory or delivered to the customer). Foreign Military Sales (FMS) transactions additionally require proof of shipment before revenue is recognized. Generally, Supply Management revenue consists of sales at standard prices less sales return. Sales of MSD 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 additional revenue.

Depot Maintenance

Current revenue recognition for Organic DMAG is the Incremental Revenue Recognition (IRR) method. This is based on completed units times the sales rate rather than the percentage of completion method. Organic DMAG will use the percentage of completion method when the Depot Maintenance Accounting and Production System (DMAPS) is implemented at Ogden Air Logistics Center (ALC) during the first quarter of FY2002. DMAPS is scheduled to be implemented at the other two ALCs, Oklahoma City and Warner Robins, by the end of FY 2003.

Revenue recognition for Contract DMAG is based on units produced times the Unit Sales Price (USP) and does not recognize IRR at this time. Contract DMAG will use the percentage of completion method for recognizing revenue when the Contract Maintenance Accounting and Production System (CMAPS) is implemented in mid FY2003.

Information Services

The Information Services Activity Group (ISAG) recognizes revenue in one of two ways as a service type organization based on the service level agreement between the customer and the provider. ISAG uses completed contract and in some instances 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 non-financial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, and accounts payable. Expenditures for capital and other long-term assets are not recognized as expenses until consumed in the Air Force's operations. Net increases or decreases in unexpended appropriations are recognized as a change in net position.

Certain expenses, such as annual and military leave earned but not taken, are financed in the period in which payment is made.

1.G. Accounting for Intragovernmental Activities

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

The Air Force's proportionate share of public debt and related expenses of the federal government are not included. Debt issued by the federal government and the related costs are not apportioned to 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 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 Air Force funds a portion of the civilian and military pensions. Reporting civilian pension under CSRS and FERS retirement systems is the responsibility of 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 OPM in the Statement of Net Cost; and recognizes corresponding imputed revenue for the civilian employee pensions and other retirement benefits in the Statement of Changes in Net Position.

The Department reports the assets, funded actuarial liability, and unfunded actuarial liability for the military personnel in the Military Retirement Fund (MRF) financial statements. The Department recognizes the actuarial liability for the military retirement health benefits in the Other Defense Organization column of the DoD Agency-wide statements.

To prepare reliable financial statements, transactions occurring between entities within the DoD or between two or more federal agencies must be eliminated. However, the Air Force, as well as the rest of the federal government, cannot accurately identify all intragovernmental transactions by customer. For FYs 1999, 2000, and 2001, seller entities within the Department provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records have been adjusted to recognize unrecorded costs and accounts payable. Intra-DoD intragovernmental balances were then eliminated.

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

1.H. Transactions with Foreign Governments and International Organizations

Each year, the DoD Components sell defense articles and services to foreign governments and international organizations, primarily under the provisions of the "Arms Export Control Act of 1976." Under the provisions of the Act, the Department has authority to sell defense articles and services to foreign countries and international organizations, generally at no profit or loss to the U.S. Government. 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 Defense Finance and Accounting Service (DFAS) and Military Service and U.S. Army Corps of Engineers (USACE) disbursing stations, as well as Department of State financial service centers. Each disbursing station prepares monthly reports, which provide information to the U.S. Treasury on check issues, electronic funds transfers, interagency transfers and deposits. In addition, the DFAS centers and the USACE Finance Center submit reports to 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 Air Force's recorded balance in the FBWT account and Treasury's FBWT may result and are subsequently reconciled.

Fund Balances with Treasury are maintained at the Air Force DWCF 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 Department of Defense level. In 1996, the DWCF was established and the FBWT was given 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. 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.

1.J. Foreign Currency

Not applicable.

1.K. Accounts Receivable

As presented in the Balance Sheet statement, accounts receivable includes accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. The Department does not recognize an allowance for estimated uncollectible amounts from 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 General Accounting Office. Only Supply Management allows for uncollectible accounts 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 data is maintained in logistics systems designed for material management purposes. Inventories are reported at approximate historical cost based on Latest Acquisition Cost (LAC) adjusted for holding gains and losses. Approximately 60% of the General Support Division is managed in the Standard Base Supply System using a Moving Average Cost for the value of the inventory. This change was effective October 2000. The remaining 40% of the GSD inventory is managed in the Stock

Control and Distribution System using the LAC method for valuation. Within the Materiel Support Division, inventory is valued at either LAC or carcass. Carcass value is calculated within the pricing system.

Only the Supply Management Activity Group maintains inventories. Gains and losses resulting from valuation changes for inventory items are 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, an inventory worksheet is prepared monthly for each fund code within the Supply Management Activity Group.

The related property portion of the amount reported on the Inventory and Related Property line reflects OM&S. The OM&S are valued at standard purchase price. Ammunition and munitions that are not held for sale are treated as OM & S. For the most part, the Department is using the consumption method of accounting for OM&S, as defined in the SFFAS No. 3. "Accounting for Inventory and Related Property," as material which has not been issued to the end user. Once OM&S is issued, the material is expensed.

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 2 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 are 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.

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/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 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 these long-term contracts can cause, the Air Force provides financing payments. One type of financing payment that the Air Force makes, for real property, is based upon a percentage of completion. In accordance with 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 Air Force makes financing payments under fixed price contracts that are not based on a 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 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 costs and the contractor is liable to repay the Air Force for the full amount of the advance. The Department has completed a review of all applicable federal accounting standards; applicable 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 Payments." DoD has concluded that SFFAS No. 1 does not fully or adequately address the subject of progress payment accounting and is considering what further 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 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, 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, 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 represents the difference, since inception of an activity between expenses and losses and financing sources including appropriations, revenue, and gains. Beginning with FY1998, this included the cumulative amount of donations and transfers of assets in and out without reimbursement.

1.V. Treaties for Use of Foreign Bases

The DoD Components have the use of land, buildings, and other facilities, which are located overseas and have been obtained through various international treaties and agreements negotiated by the Department of State. The DoD capital assets overseas are purchased with appropriated funds; however, title to land and improvements are retained by the host country. 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 which allow for the continued use by the Department. Therefore, in the event treaties or other agreements are terminated whereby use of foreign bases is no longer allowed, losses will be recorded for the value of any nonretrievable capital assets after negotiations between the United States and the host country have been concluded to determine the amount to be paid the United States for such capital investments.

1.W. Comparative Data

Beginning in FY 2001, the Air Force will present the current and previous years' financial data for comparative purposes. This data will be presented in the financial statements, as well as in the notes to the principal statements. Material variances of 10% or more on the Balance Sheet and the Statement of Net Cost will be discussed in the applicable footnote.

1.X. Unexpended Obligations

The Air Force records obligations for goods and services that have been ordered but not yet received. No liability for payment has been established in the financial statements because goods/services have yet to be delivered.

Note 2. Assets

As of September 30,	2001 Total		2000	
(Amounts in thousands)				
Intragovernmental Assets:				
Fund Balance with Treasury	$	556,603	$	214,627
Accounts Receivable		461,229		729,449
Other Assets		57,320		65,592
Total Intragovernmental Assets	$	1,075,152	$	1,009,668
Nonfederal Assets:				
Cash and Other Monetary Assets	$	0	$	102
Accounts Receivable		105,290		73,578
Inventory & Related Property		11,056,384		17,310,658
General Property, Plant and Equipment		1,258,047		1,255,368
Other Assets		468,474		790,490
Total Nonfederal Assets	$	12,888,195	$	19,430,196
Total Assets:	$	13,963,347	$	20,439,864

Composition and variances of assets are explained in detail in the following subsequent notes:

Fund Balance with Treasury: Note 3

Accounts Receivable: Note 5

Other Assets: Note 6

Inventory and Related Property: Note 9

General Property, Plant and Equipment: Note 10

Note 3. Fund Balance with Treasury

As of September 30,	2001	2000
(Amounts in thousands)		
Fund Balances:		
Revolving Funds	$ 556,603	$ 214,627
Fund Balances Per Treasury Versus Agency:		
Fund Balance per Treasury	$ 918,537	$ 542,600
Fund Balance per AF WCF	556,603	214,627
Reconciling Amount	$ 361,934	$ 327,973

Explanation of Reconciliation Amount

The reconciling amount above represents $361,934,413 for United States Transportation Command (USTC) which is reported by Treasury as part of Air Force Working Capital Fund and reported as Other Defense Organizations for AFS. See footnote 1C(2) in the USTC footnotes for further information concerning this matter. Additionally, a reconciling amount of $303 for SMAG was corrected during FY 2002.

Other Information

The overall FBWT for AFWCF increased in FY01 in the amount of $342M. The AFWCF is required to maintain an operating cash balance of at least $200M. Prior to September, the overall FBWT was approaching a critical level, indicating the need for the advance billing. In Sep 2001 SAF and AFMC requested an advance billing to DMAG customers in the amount of $500M. The full effect of these advance billings is not realized because in FY01 the AFWCF exceeded planned net operating losses in the amount of $137M.

The SMAG business area has a negative fund balance of $98M, which has shown an improvement over the prior year negative fund balance of $261M. When cash was transferred from the Department of Defense WCF to the Air Force level in 1996, insufficient levels of cash were received to cover the corresponding liabilities. Disconnects in pricing in prior years also contributed to the negative balance. Consumable Item Transfers and reductions in overhead expenses are allowing for the increase in cash. In addition, SMAG has continued accelerated billing to maintain the cash balance. Billings are processed twice a month for most locations, allowing for timely cash inflows.

Differences exist between the FBWT and activity (field) reported disbursements and collections. These differences are accounted for in the undistributed collections and disbursements general ledger accounts, and are mostly supported. Refer to the supplementary information in Note 24A for a detailed explanation of undistributed accounts.

Note 4. Investments

Not Applicable

Note 5. Accounts Receivable

As of September 30,	2001			2000
	Gross Amount Due	Allowance for Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
(Amounts in thousands)				
Intragovernmental Receivables:	$ 461,229	N/A	$ 461,229	$ 729,449
Nonfederal Receivables (From the Public):	$ 107,795	$ (2,505)	$ 105,290	$ 73,578
Total Accounts Receivable:	$ 569,024	$ (2,505)	$ 566,519	$ 803,027

Allowance Method

The Supply Management Activity Group uses an allowance method for non-government receivables, which is based on historical data. Depot Maintenance and Information Services generally use the direct write-off method for uncollectible accounts.

Other information

The Air Force accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the Air Force was unable to reconcile intragovernmental accounts receivable balances with its trading partners. The DoD intends to develop long-term systems improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliation can not be accomplished with the existing or foreseeable resources.

The total undistributed collections applied to accounts receivable for the AFWCF was ($135 billion), and is broken out by business area in the table below. See supplementary information in Note 24A for additional discussion of undistributed.

Schedule of Undistributed Collections Applied to Accounts Receivable (in Thousands)

	DMAG	ISAG	SMAG	AF TRANS	Component	Total
A/R prior to Undistributed	388,692	44,696	269,035	0	0	702,422
Amount of Undistributed	503	(9,703)	(10,393)	617	(116,927)	(135,903)
A/R After Undistributed	389,195	34,993	258,642	617	(116,927)	566,519

Aged Schedule of Accounts Receivable (in Thousands)

	DMAG	ISAG	SMAG	AF TRANS	Component	Total
Federal A/R less than 180 days	387,447.00	46,500.00	378,979.00	0.00	0.00	812,926.00
Federal A/R over 180 days	3,909.00	2,	7,570.00	0.00	0.00	11,481.00
Less: Eliminations	(150,969.00)	(11,509.00)	(200,700.00)	0.00	0.00	(363,177.00)
Total Federal A/R	240,387.00	34,993.00	185,849.00	0.00	0.00	461,230.00
Non-Federal A/R less than 180 days	147,798.00	0.00	59,911.00	0.00	0.00	207,710.00
Non-Federal A/R over 180 days	1,009.00	0.00	12,881.00	617.00	(116,927.00)	(102,420.00)
Total Non-Federal A/R	148,808.00	0.00	72,792.00	617.00	(116,927.00)	105,290.00
Total A/R	389,195.00	34,993.00	258,641.00	617.00	(116,927.00)	566,520.00

The total A/R decrease of $236 million can be attributed to more aggressive collection of outstanding receivables and validation and correction of accounts receivable balances. In SMAG extensive efforts have been devoted to validating and resolving large accounts receivable balances. While significant progress was achieved, there remains approximately $70 million that is questionable and still needs to be researched. The DMAG increase of $1 million in nonfederal accounts receivable from FY 2000 to FY 2001 is due to an erroneous posting in September 2001 of federal accounts receivables to the nonfederal account. This created an overstatement of nonfederal accounts receivable and an understatement of federal accounts receivable by this amount. The remaining decrease in DMAG intragovernmental accounts receivable is due to the discovery of a problem with the posting of DMAG organic incremental revenue recognition. A team from AFMC, SAF, and DFAS discovered this problem in midyear FY 2001. The posting ignored the fact that work orders associated with the revenue recognition were already included in progress billings. Thus, both accounts receivable and progress billings were overstated. The team recommended the liquidation of progress billings before updating unbilled accounts receivable.

Note 6. Other Assets

As of September 30,	2001	2000
(Amounts in thousands)		
Intragovernmental Other Assets:		
Advances and Prepayment	$ 56,322	$ 65,592
Other Assets	998	0
Total Intragovernmental Other Assets	$ 57,320	$ 65,592
Nonfederal Other Assets:		
Other Assets (With the Public)	468,474	790,490
Total Other Assets:	$ 525,794	$ 856,082

The Air Force reports outstanding financing payments for fixed price contracts as an advance and prepayment, because under the terms of the fixed price contracts, 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 costs and the contractor is liable to repay the Air Force for the full amount of the outstanding contract payments. The Department has completed its review of all applicable federal accounting standards; applicable public laws on contract financing; Federal Acquisition Regulation Parts 32, 48, and 52; and the OMB guidance in 5 CFR Part 1315, "Prompt Payment." The Department has concluded that the SFFAS No. 1, Accounting for Selected Assets and Liabilities does not fully or adequately address the subject of progress payment accounting and is considering what further action is appropriate.

Intragovernmental Other Assets

In Materiel Support Division the FY01 buyer-side advances to others were adjusted upward $56 million to agree with seller-side advances from others on the books of other DoD reporting entities. Returns pending credit were also adjusted to agree with seller-side data, with an ending total of $998 thousand. The total intergovernmental other assets, entirely from the SMAG/MSD business area, is $57 million. The overall decrease in FY01 is attributed to less adjustments needed for elimination entries.

Nonfederal Other Assets

Total Nonfederal Other Assets represents advances to contractors totaling $153 million and other assets totaling $315 million. SMAG has $108 million in Advances with the Public. DMAG has $45 million in advances to contractors, a decrease of $87 million from FY2000. This is attributed directly to the closures of San Antonio Air Logistics Center and Sacramento Air Logistics Center in FY2001.

The remaining other assets in the amount of $315 million belongs to the SMAG business area. The majority is reported by four Air Logistics Centers as sales of Materiel Support Division (MSD) assets to foreign governments. These deliveries cannot be billed until each delivery is matched to a proof of shipment within the Security Assistance Management Information System (SAMIS).

The Other Nonfederal Assets account consists of the following categories and dollar amounts, in thousands:

Other assets accounts receivable—deliveries suspense	$40,260
Air Force assets - other DoD foreign military sales (depot)	(138)
Uncollected overhead (Kelly)	15,677
Other assets returns to vendors pending credit	259,332
Other assets miscellaneous other assets	3
Total	$315,134

The above amount for other assets accounts receivable—deliveries suspense has been overstated by values from 1993 and prior years. Air Force and DFAS are aware of a material misstatement of this balance that resulted from system problems between FIABS and SAMIS. AFMC and DFAS are currently working to resolve this problem. An adjustment of $376 million was made to SMAG other assets accounts receivable—deliveries expense shown above to correct the misstatement in FY01.

Note 7. Cash and Other Monetary Assets

As of September 30,	2001	2000
(Amounts in thousands)		
Cash	$ 0	$ 102

At the end of FY01, the AFWCF had no cash or monetary assets on hand.

Note 8. Direct Loan and/or Loan Guarantee Programs

Not Applicable

Note 9. Inventory and Related Property

As of September 30,	2001	2000
(Amounts in thousands)		
Inventory, Net (Note 9.A.)	$ 10,080,074	$ 16,398,922
Operating Materials & Supplies, Net (Note 9.B.)	976,310	911,736
Total	$ 11,056,384	$ 17,310,658

Note 9.A. Inventory, Net

As of September 30,	2001			2000	
	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Inventory, Net	Valuation Method
(Amounts in thousands)					
Inventory Categories:					
Available and Purchased for Resale	$ 18,967,389	$ (13,328,700)	5,638,689	$ 4,584,980	LAC/O
Held for Repair	10,431,539	(7,176,992)	3,254,547	10,451,341	LAC/O
Excess, Obsolete, and Unserviceable	4,426,925	(4,342,814)	84,111	119,303	NRV
Work in Process	1,102,727	0	1,102,727	1,243,298	AC
Total	$ 34,928,580	$ (24,848,506)	10,080,074	$ 16,398,922	

Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses holding gains and losses

NRV = Net Realizable Value

AC = Actual Cost

O = Other

Definitions: Inventory, Gross Value represents the standard value used for inventory transaction in the financial system. Revaluation Allowance is the total different between standard inventory values and historical cost or net realizable value. Inventory, Net is approximate historical cost or net realizable value

Other Information

Inventory values reported in the financial statements are derived from logistics systems designed for materiel management purposes. The General Support Division systems value inventory at moving average, however, the Material Support Division systems do not maintain the historical cost data necessary to comply with the SFFAS No. 3, "Accounting for Inventory and Related Property. All the inventory systems provide management with accountability information and visibility over inventory items. These logistics systems support the categorization of inventory as; held for sale, held in reserve for future sale, or excess, obsolete, and unserviceable, yet, the business practices in the supply community do not use these categories. Additionally, past audit results have led to uncertainties about the completeness and existence of the inventory quantities used to derive the balances reported in the financial statements.

Approximately 60% of the General Support Division is managed in the Standard Base Supply System using a Moving Average Cost for the value of the inventory. This change was effective October FY01. The remaining 40% of the GSD inventory is managed in the Stock Control and Distribution System using the LAC method for valuation.

Excess, Obsolete and Unserviceable Inventory are re-valued from their standard or moving average price to their net realizable value (NRV). Based upon current policies and procedures, the NRV is 1.9 percent of the price. Therefore the reported value of Excess, Obsolete and Unserviceable inventory value was reduced approximately $4.3 billion.

The Depot Maintenance Activity Group has approximately $1.1 million recorded in Work in Process in note 9.A. because the U.S. Government Standard General Ledger (USSGL) does not provide a Work in Process account under Operating Materials and Supplies. This amount recorded in the Work in Process account represents labor, applied overhead, and supplies used in the delivery of maintenance services. The decrease in DMAG Work in Process (WIP) from FY2000 to FY2001 is directly attributable to the closures of the San Antonio and Sacramento ALCs and contracting out more work.

In the SMAG Materiel Support Division, the inventory reconciliation program in the Standard Materiel Accounting System was changed for July processing to correctly reflect the balances in the supply system. This resulted in a decrease in the value of the inventory amounting to approximately $6.3 billion.

Note 9.B. Operating Materials and Supplies, Net

As of September 30,	2001	2000	
	OM&S Amount	OM&S, Net	Valuation Method
(Amounts in thousands)			
Held for Use	$ 976,310	$ 911,736	O

Legend for Valuation Methods:
O = Other

The Operating Materials & Supplies (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 its operating materials and supplies 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 is using 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. For FY 2001, significant portions of the Air Force's OM&S were reported under the purchase method - expensed when purchased - either because the systems could not support the consumption method of accounting or because management believes the items to be in the hands of the end user.

Note 10. General PP&E, Net

As of September 30,	2001								2000	
	Depreciation/ Amortization Method	Service Life	Acquisition Value		(Accumulated Depreciation/ Amortization)		Net Book Value		Prior FY Net Book Value	
(Amounts in thousands)										
Major Asset Classes:										
Buildings, Structures, and Facilities	S/L	20 Or 40	$	811,598	$	(522,615)	$	288,983	$	376,258
Software	S/L	2-5 Or 10		350,430		(125,115)		225,315		154,015
Equipment	S/L	5 Or 10		2,062,427		(1,494,743)		567,684		582,254
Construction-in-Progress	N/A	N/A		176,065		N/A		176,065		142,841
Total General PP&E			$	3,400,520	$	(2,142,473)	$	1,258,047	$	1,255,368

Legend for Valuation Methods:
S/L = Straight Line N/A = Not Applicable

In Fiscal Year 2001, real property reported by the Automated Civil Engineering System (ACES), personal property reported by the Air Force Equipment Management System (AFEMS), and the Information Processing Management System (IPMS), data has not been validated and reconciled to reported figures received from the field activities by DFAS. However, the Depot Maintenance ALCs and Aerospace Maintenance and Regeneration Center (AMARC) use the Automated Civil Engineer System (ACES) to capture the costs of real property based on preponderance of use for each building. The accounting entries are recorded directly into the field level trial balances. With the implementation of the Defense Industrial Fund Management System (DIFMS), ACES will be the source for all real property accounting entries. The Ogden ALC implements DIFMS the first quarter of FY2001, and the other ALCs are scheduled to implement DIFMS by the end of FY 2003.

Any WCF 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 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. In accordance with an approved strategy with the Office of Management and Budget, the General Accounting Office and the Inspector General, DOD is developing new policies and a contractor reporting process to capture General PP&E information for future reporting purposes for compliance with federal-wide accounting standards.

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

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30,	2001			2000
	Covered by Budgetary Resources	Not Covered by Budgetary Resources	Total	
(Amounts in thousands)				
Intragovernmental Liabilities:				
Accounts Payable	$ 143,833	$ 0	$ 143,833	$ 192,597
Other	353,537	0	353,537	25,379
Total Intragovernmental Liabilities	$ 497,370	$ 0	$ 497,370	$ 217,976
Nonfederal Liabilities:				
Accounts Payable	$ 1,328,019	$ 0	$ 1,328,019	$ 201,906
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	0	242,137	242,137	198,890
Other Liabilities	3,111,789	0	3,111,789	3,346,456
Total Nonfederal Liabilities	$ 4,439,808	$ 242,137	$ 4,681,945	$ 3,747,252
Total Liabilities:	$ 4,937,178	$ 242,137	$ 5,179,315	$ 3,965,228

Refer to Notes 12 and 15 for further information regarding Accounts Payable and Other Liabilities covered by budgetary resources.

The $242 million in Military Retirement Benefits and Other Employment-Related Actuarial Liabilities represents AFWCF FY2001 Workman's Compensation. Amounts are broken out by business area as follows (in thousands):

SMAG	$ 19,284
DMAG	$211,867
ISAG	$10,986

Note 12. Accounts Payable

As of September 30,	2001	2000
	Total	Total
(Amounts in thousands)		
Intragovernmental Payables	$ 143,833	$ 192,597
Nonfederal Payables (to the Public):	$ 1,328,019	$ 201,906
Total	$ 1,471,852	$ 394,503

Intragovernmental Accounts Payable. For the majority of buyer-side transactions, the Air Force WCF's accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the Air Force WCF was unable to reconcile intragovernmental accounts payable balances with its trading partners. The Air Force intends to develop long-term systems improvements that will include sufficient upfront edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished with the existing or foreseeable resources.

The DoD summary level seller accounts receivables were compared to each business area's accounts payable. Adjustments were posted to DMAG's accounts payable based on the comparison with the accounts receivable of the DoD Components providing goods and services to each business area. Positive differences were treated as unrecognized accounts payable and accounts payable were adjusted upwards in the amount of $193 million for DMAG, $2,734 million for SMAG, and $3,360 million for ISAG.

Three DMAG entities had abnormal Accounts Payable balances on their trial balances, so accruals were done for Warner Robins Contract, Warner Robins Organic, and Oklahoma City Contract to bring their abnormal balances up to $0.00, as illustrated below. In the following presentation of values, parenthesis indicate credit balances. The last column indicates the amount of Accrued Accounts Payable offsetting the abnormal balances. In the case of the abnormal undistributed for Warner Robins Organic, the entire amount was applied against the Federal Accounts Payable rather than pro rata to the Non-Federal Accounts Payable as this would have caused an increase in an existing abnormal balance.

Distribution of Undistributed Disbursements for DMAG with Abnormal Balances (in Thousands)

		Beginning Abnormal Undistrisbuted	Accounts Payable Before Distribution	A/P after Allocation of Undistributed	Accrued A/P to Offset Abnormal Balances
Federal					
Warner	Contract	41,404	10,491	51,895	(51,895)
Warner	Organic	7,441	(33,118)	(25,677)	0
Oklahoma	Contract	73,453	83,196	156,649	(156,649)
Federal subtotal:		122,298	60,569	182,867	(208,544)
Public					
Warner	Contract	123	(123)	0	0
Warner	Organic	0	1,348	0	(1,348))
Oklahoma	Contract	6,059	(6,059)	0	
Public subtotal:		6,182	(4,835)	0	(1,348)

The amount of undistributed disbursements that were applied to accounts payable for SMAG was $376 million, DMAG was $182,686 million ISAG was $22,415 million and AFTrans was $951 million. The positive amounts decreased Accounts Payable and the negative amounts increased Accounts Payable.

Distribution of Undistributed Disbursements for AFWCF after Addressing Abnormal Balances (in Thousands)

	Accounts Payable	Amount of Undistributed	Adjusted A/P
Federal			
DMAG	215,959	156,425	59,534
ISAG	22,793	22,415	378
SMAG	719,760	233,631	486,129
Component	0	0	0
AF TRANS			
Federal subtotal:	958,512	412,471	546,041
Public			
DMAG	26,996	26,262	734
ISAG	14,752		14,751
SMAG	268,961	142,392	126,569
Component	204,566	0	204,566
AFTRANS	298	(951)	1,250
Public subtotal:	515,573	167,703	347,870

Accounts Payable after Distribution of Undistributed with Accruals for Eliminations (in Thousands)

	Adjusted A/P	Accruals	A/P after Accrual	AFWCF Intra-Eliminations	Combined A/P
DMAG	129,436	150,488	279,924	(203,409)	76,515
ISAG	378	2,278	2,655	(29)	2,626
SMAG	550,293	(325,876)	224,417	(159,740)	64,678
Component					
AF TRANS					
	680,107	(173,110)	506,996	(363,178)	143,819
DMAG	734		734		734,
ISAG	14,751		14,751		14,751
SMAG	231,826	1,284,032	1,515,859		1,515,859
Component	(204,565)		(204,566)		(204,566)
AFTRANS	1,250		12,450		1,250
	43,996	1,284,032	1,328,028	0	1,328,028

Note 13. Debt

Not applicable

Note 14. Environmental Liabilities and Environmental Disposal Liabilities

Not applicable

Note 15.A. Other Liabilities

As of September 30,	2001			2000
	Current Liability	Noncurrent Liability	Total	Total
(Amounts in thousands)				
Intragovernmental:				
Advances from Others	$ 347,383	$ 0	$ 347,383	$ 11,826
Deposit Funds and Suspense Account Liabilities				1,740
Other Liabilities	6,154	0	6,154	11,813
Total Intragovernmental Other Liabilities	$ 353,537	$ 0	$ 353,537	$ 25,379

As of September 30,	2001			2000
	Current Liability	Noncurrent Liability	Total	Total
(Amount in Thousands)				
Nonfederal:				
Accrued Funded Payroll and Benefits	$ 150,329	$ 0	$ 150,329	$ 154,204
Advances from Other	1,212	0	1,212	909
Other	0	0	0	(985)
Other Liabilities	2,960,248	0	2,960,248	3,192,328
Total Nonfederal Other Liabilities	$ 3,111,789	$ 0	$ 3,111,789	$ 3,346,456
Total Other Liabilities:	$ 3,465,326	$ 0	$ 3,465,326	$ 3,371,835

Intragovernmental

Advances from Others in the amount of $347 million are from the DMAG business area, and represent a portion of the $500M advanced billings in September (refer to Note 3). The advance billing resulted in a large increase in advances over the prior year.

Other liabilities consist of $6 million in accrued payroll and employer contributions payable. These liabilities are classified as intergovernmental as they are provided by the Department of Labor and elimination entries are necessary. DMAG's portion is $5 million , ISAG is $31 thousand, and SMAG is $487 thousand.

Nonfederal

Accrued Funded Payroll and Benefits of $150 million represents leave and benefits owed to employees. The ISAG portion is $11 million, the DMAG portion is $127 million, the SMAG portion is $9 million, and the AFTRANS portion is $1 million. The amount in AFTRANS is a residual balance that has carried forward from prior years, and will be researched and eliminated with the final closing of the activity projected for FY02. These benefits are classified as funded, as they are included in computing the rates that the AFWCF activities charge their customers.

Advances from Others in the amount of $1 million are from the DMAG business area. This amount represents a portion of the advance billing referenced above and Note 3.

Nonfederal other liabilities total $3 billion. This amount represents DMAG progress billings, $834 million and work in progress accrued expenses, $1,924 million for a total DMAG amount of $2,759 million. The ISAG portion of $116 million represents contract services and various miscellaneous items.

The SMAG portion of $84 million represents contract holdbacks in the amount of $274 thousand and other liabilities amounting to $83 million, which is 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.

Note 16. Commitments and Contingencies

Not Applicable.

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

As of September 30,	2001			2000
	Actuarial Present Value of Projected Plan Benefits	Assumed Interest Rate (%)	Unfunded Actuarial Liability	Unfunded Actuarial Liability
(Amounts in Thousands)				
FECA	$ 242,137	5	$ 242,137	$ 198,890
Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities	$ 242,137		$ 242,137	$ 198,890

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 economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

2001
5.21% in year 1
5.21% in year 2
And thereafter

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

CBY	COLA	CPIM
2001	3.33%	4.44%
2002	3.00%	4.15%
2003	2.56%	4.09%
2004	2.50%	4.09%
2005+	2.50%	4.09%

The model's resulting projections were analyzed to insure 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 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 ration calculated for the prior projection.

Note 18. Unexpended Appropriations

As of September 30,	2001	2000
(Amounts in Thousands)		
Unexpended Appropriations:		
Unobligated, Available	$ 0	$ 63,971

The $63,971 thousand was erroneously reported as Unexpended Appropriations in FY 2000 and has been corrected in FY 2001.

Note 19.A General Disclosures Related to the Statement of Net Cost

The amounts presented in the Statement of Net Cost are based on obligations and disbursements and therefore may not in all cases report actual accrued costs. The Air Force generally records transactions on a cash basis and not an accrual basis as is required by generally accepted accounting principles. Therefore, the Air Force's systems do not capture all actual costs. As such, information presented in the statement of Net Cost is based on budgetary obligations, disbursements, and collection transactions, as well as nonfinancial feeder systems; and is adjusted to known accruals for major items such as payroll expenses, accounts payable, environmental liabilities, etc. and known imputed expenses.

Note 19.B. Imputed Expenses

As of September 30,	2001	2000
(Amount in thousands)		
Civilian (e.g.,CSRS/FERS) Retirement	$ 47,613	$ 43,428
Civilian Health	76,615	63,436
Civilian Life Insurance	204	170
Total Imputed Expenses	$ 124,432	$ 107,034

Note 19.C. Intragovernmental Revenue and Expense

The majority of DoD accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, most DoD Agencies were unable to reconcile intragovernmental revenue balances with their trading partners. The Department 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 Air Force's operating expenses were adjusted based on a comparison between the Air Force'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 Air Force were adjusted upwards in the amount of $1,368,948 thousand.

Note 20. Disclosures Related to the Statement of Changes in Net Position

As of September 30,	2001	2000
(Amounts in thousands)		
Prior Period Adjustments Increases (Decreases) to Net Position Beginning Balance:		
Other Prior Period Adjustments	(3,462,470)	(1,419,599)
Total Prior Period Adjustments	$ (3,462,470)	$ (1,419,599)
Imputed Financing:		
Civilian CSRS/FERS Retirement	$ 47,613	$ 43,428
Civilian Health	76,615	63,436
Civilian Life Insurance	204	170
Military Retirement Pension	0	0
Total Imputed Financing	$ 124,432	$ 107,034

Other Information (in thousands)

Other Prior Period Adjustments	
ISAG Cleanup of A/P and Travel advances	788
DMAG closure of accumulated operation results for ALCs at San Antonio and Sacramento	161,543
SMAG MSD, adjustments for FMS receivables	(367,325)
SMAG MSD, adjustments for Purchases at Standard Price	(514,970)
SMAG GSD, adjustment for LAC/ MAC conversions	129,363
SMAG Fuels, Unsupported Accounts Receivable Adjustments	(165,058)
SMAG, 1307 change in presentation	(2,706,811)
Total of Other Prior Period Adjustments	**(3,462,470)**

Adjustments for FMS Receivables: These adjustments were computed by DFAS-DE and coordinated with HQ AFMC/FM. Attempts to reconcile this account for the period FY1993-1997 were not successful so the prior period adjustment established a baseline for the FY2001. pending systems changes in FY2002.

Adjustments for Purchases at Standard Price: An adjustment was done for MSD to correct Purchases at Standard Price. A processing error was identified for Purchases at Standard Price.

Adjustments for LAC/MAC Conversions: Effective October 2000 the inventory valuation method was changed for all General Support Division (GSD) inventory supported by the Standard Base Supply System (SBSS) from latest acquisition cost (LAC) to moving average cost (MAC) (60%). The GSD inventory supported by the Stock Control and Distribution System (D035K) remained at LAC (40%). This change drove a change to the financial statements because the inventory allowance technique only applies to inventory valued at LAC. The inventory allowance as of October 1, 2000 applied to the entire GSD inventory as of that date. The journal voucher for the amount of the inventory allowance that applied to the SBSS inventory was processed to reduce the inventory allowance and record the prior period adjustment. This supported the need to provide financial statements that fairly represented the net value of the inventory.

Note 21.A. Disclosures Related to the Statement of Budgetary Resources

As of September 30,	2001	2000
(Amounts in thousands)		
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 5,312,691	$ 5,139,151
Available Borrowing and Contract Authority at the End of the Period	1,093,918	700,863

The Department has identified the Government Performance and Results Act (GPRA) performance measures based on missions and outputs. The Department, however, is unable to accumulate costs for major programs based on those performance measures, because its financial processes and systems were not designed to collect and report this type of cost information. Until the process and systems are upgraded, the Department will break out programs by its nine major appropriation groupings.

Undelivered Orders Presented in Statement of Budgetary Resources:

Undelivered Orders presented in the Statement of Budgetary Resources includes Undelivered Orders-Unpaid for both Direct and Reimbursable funds. It does not include Undelivered Orders-Paid

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 Statement of Budgetary Resources), are not included in "Spending Authority From Offsetting Collections and Adjustments" line of the Statement of Budgetary Resources or the "Spending Authority for Offsetting Collections and Adjustments" line of the Statement of Financing.

Intraentity transactions have not been eliminated because the statements are present as combined and combining.

Budget Authority:

Depot Maintenance received an appropriation in the amount of $8,375 thousand through a Treasury Appropriation Warrant.

Abnormal Balance:

Depot Maintenance has an abnormal unobligated balance - beginning of period on the Combining Statement of Budgetary Resources. This is due to an overstatement of obligations created on the Contract side of DMAG by a duplication of reporting material inventories at contractors' facilities. These same materials are reported under two different General Ledger Accounts, once as an estimated amount of material usage, and once as the actual amount of material usage.

Note 21.B. Disclosures Related to Problem Disbursements, In-transit Disbursements and Suspense/Budget Clearing Accounts

As of September 30,	2000	2001	Cumulative (Decrease)/ Increase
(Amounts in thousands)			
Problem Disbursements	$ 20	$ 20	$ 0
In-transit Disbursements, Net	$ 545	$ 606	$ 61

The Air Force has $627 million problem disbursements and in-transit disbursements that represent disbursements of Air Force funds that have been reported by a disbursing station to the Department of the Treasury but have not yet been precisely matched against the specific source obligation giving rise to the disbursements. For the most part, these payments have been made using available funds and based on valid receiving reports for goods and services delivered under valid contracts. The problem disbursements and in-transit disbursements arise when the various contracting, disbursing, and accounting systems fail to match the data necessary to properly account for the disbursement transactions in all applicable accounting systems. Defense Finance and Accounting Service has efforts underway to improve the systems and to resolve all previous problem disbursements and to process all in-transit disbursements. There was no significant change to Problem Disbursements since September 2000. In-transit disbursements have increased $61 million since September 2000. In-transit disbursements increased primarily due to realignment of workload between the Field Sites to better serve our customers. This has caused delays in the processing of transactions as the transactions were routed to the incorrect accounting station and then had to be transferred to the correct accounting station. A secondary cause was the implementation of Departmental Cash Management System For and By Others (DFB) system. Implementation started in July 1999 and completed in July 2001. We experienced a four-month learning curve at each Field Site with this new system that also delayed the processing of by-others transactions. We anticipate significant benefits from both of these initiates in fiscal year 2002. Previous year's reports have shown only aged in-transit disbursements. This report includes all in-transit disbursements for the two years shown.

Note 22. Disclosures 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 and the Statement of Financing. On the Statement of Financing, Transfers-In, Costs Capitalized on the Balance Sheet and Collections that Decrease Credit Program Receivables or Increase Credit Program Liabilities were adjusted in order to align the amount of net cost on the Statement of Financing with the amount reported on the Statement of Net Cost. Detail of adjustments by line follow.

Statement of Financing Adjustments (in Thousands)

	Adjustment	SOF Line 1E	SOF Line Fin 2C	SOF Line 2E
AF TRANS	(346)		(346)	
DMAG	162,568		162,568	
ISAG	2,775		2,775	
SMAG	(2,847,049)	65,500	(2,916,450)	3,901
Total	(2,682,052)	65,500	(2,751,453)	3,901

Note: credits (indicated by parenthesis) represent increases. Intraentity transactions have not been eliminated because the statements are presented as combined and combining.

Note 23. Disclosures Related to the Statement of Custodial Activity

Not Applicable.

Note 24. Other Disclosures

Undistributed Collections and Disbursements

Timing differences often occur between when cash transactions are recorded at Treasury and when the field records the transactions in the general ledger. The differences are accounted for in the undistributed collection and disbursements accounts, which offset accounts receivable and accounts payable in the accounting records. Undistributed amounts are reconciled monthly to ensure that they are fully supported. With the exception of the Material Support Division, all of the undistributed transactions are 100% supported.

Various categories make up the total undistributed. Intransit items and uncleared interfund represent the majority of the undistributed. The intransit category consists of transactions that are paid/collected by one entity on behalf of another entity. The transaction is recorded at Treasury in the month of occurrence, however it generally takes 30-60 days to be distributed to the accountable entity. Interfund transactions are intra-government no check drawn transactions that are generated by the billing activity at end of month. They are then transmitted to a central location to be distributed to the accountable entity. Since this is an end of month process, the accountable entity does not receive the data until the next month. Recons and suspense are also a category of undistributed. Recons are created when the cumulative disbursements and collections reported by the field entities on monthly reports do not equal cumulative amounts generated from current month transactions. When differences occur between the fields weekly and monthly reports, the amount is suspensed until out of balances can be researched and corrected in subsequent months. The suspense category may also contain amounts that are not supported by voucher data, but have been reported to Treasury. Once again, this is researched and corrected. Other miscellaneous posting errors can contribute to undistributed balances, which are identified monthly and corrected at the appropriate location.

The Material Support Division currently has an unsupported balance of $28M. In FY01, the unsupported balance has been stabilized for the most part. The accountability for this appropriation is shared between Denver and Columbus. Procedures have been developed to separate the actual FBWT between the two sites. The Denver site has been able to support its portion of the undistributed. Procedures are still being developed with Columbus to support their portion. Plans are in place for Denver to take over accountability for the entire appropriation in FY03. This will bring all of the supporting information into Denver systems and will allow complete reconciliation. ISAG currently has an unsupported balance of $16M, which is also stabilized. Research is being conducted with the Cleveland DFAS center to resolve the unsupported amounts. Overall, the unsupported undistributed represents only 7 percent of the total undistributed.

Performance measurements are in place to ensure timely processing of AFWCF transactions. In addition, new systems were implemented in FY01 that should impact the time frames involved in processing transactions in future years, which should decrease the total undistributed.

Working Capital Fund

Consolidating and Combining Statements

Consolidating Balance Sheet—Working Capital Fund

For the years ended September 30 ($ in Thousands)

	Depot Maintenance	Supply Management	Information Services
ASSETS *(Note 2)*			
Intragovernmental:			
Fund Balance with Treasury *(Note 3)*	$ 581,842	$ (97,733)	$ 61,468
Accounts Receivable *(Note 4)*	390,811	385,516	46,476
Other Assets *(Note 5)*	0	57,320	0
Total Intragovernmental Assets	$ 972,653	$ 345,103	$ 107,944
Cash and Other Monetary Assets *(Note 7)*	0	0	0
Accounts Receivable *(Note 5)*	148,808	72,792	0
Inventory and Related Property *(Note 6)*	1,788,335	9,268,049	0
General Property, Plant and Equipment *(Note 10)*	995,413	191,394	30,725
Other Assets	45,259	423,215	0
TOTAL ASSETS	$ 3,950,468	$ 10,300,553	$ 138,669
LIABILITIES *(Note 11)*			
Intragovernmental:			
Accounts Payable *(Note 12)*	$ 279,379	$ 223,393	$ 2,634
Other Liabilities *(Note 15 & Note 16)*	352,712	487	338
Total Intragovernmental Liabilities	$ 632,091	$ 223,880	$ 2,972
Accounts Payable *(Note 12)*	1,061	1,515,523	$ 14,751
Military Retirement Benefits & Other Employment-Related Actuarial Liabilities	211,867	19,284	10,986
Other Liabilities *(Note 15 and Note 16)*	2,888,234	93,987	128,104
TOTAL LIABILITIES	$ 3,733,253	$ 1,852,674	$ 156,813
NET POSITION			
Unexpended Appropriations *(Note 18)*	$ 0	$ 0	$ 0
Cumulative Results of Operations	217,215	8,447,879	(18,144)
TOTAL NET POSITION	$ 217,215	$ 8,447,879	$ (18,144)
TOTAL LIABILITIES AND NET POSITION	$ 3,950,468	$ 10,300,553	$ 138,669

The accompanying notes are an integral part of the financial statements.
See notes 1 and 21.

Transportation	Component Level	Combined Total	Intra-Entity Eliminations	FY 2001 Consolidated Total	FY 2000 Consolidated Total
$ 10,225	$ 801	$ 556,603	$ 0	$ 556,603	$ 214,627
(1)	1	822,803	361,574	461,229	729,449
0	0	57,320	0	57,320	65,592
$ 10,224	$ 802	$ 1,436,726	$ 361,574	$ 1,075,152	$ 1,009,668
0	0	0	0	0	102
617	(116,927)	105,290	0	105,290	73,578
0	0	11,056,384	0	11,056,384	17,310,658
40,515	0	1,258,047	0	1,258,047	1,255,368
0	0	468,474	0	468,474	790,490
$ 51,356	$ (116,125)	$ 14,324,921	$ 361,574	$ 13,963,347	$ 20,439,864
$ 0	$ 1	$ 505,407	$ 361,574	$ 143,833	$ 192,597
0	0	353,537	0	353,537	25,379
$ 0	$ 1	$ 858,944	$ 361,574	$ 497,370	$ 217,976
$ 1,250	$ (204,566)	$ 1,328,019	$ 0	$ 1,328,019	$ 201,906
0	0	242,137	0	242,137	196,890
1,464	0	3,111,789	0	3,111,789	3,346,456
$ 2,714	$ (204,565)	$ 5,540,889	$ 361,574	$ 5,179,315	$ 3,965,228
$ 0	$ 0	$ 0	$ 0	$ 0	$ 63,971
48,642	88,440	$ 8,784,032	0	8,784,032	16,410,665
$ 48,642	$ 88,440	$ 8,784,032	$ 0	$ 8,784,032	$ 16,474,636
$ 51,356	$ (116,125)	$ 14,324,921	$ 361,574	$ 13,963,347	$ 20,439,864

The accompanying notes are an integral part of the financial statements.
See notes 1 and 21.

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Consolidating Statement of Net Cost—Working Capital Fund

For the years ended September 30 ($ in Thousands)

	Total	Intra-Entity Eliminations	FY 2001 Consolidated Total	FY 2000 Consolidated Total
Program Costs				
Depot Maintenance				
Intragovernmental	$ 2,826,795	$ (1,761,973)	$ 1,064,822	$ 905,546
With the Public	3,512,605	0	3,512,605	3,410,535
Total Program Cost	$ 6,339,400	$ (1,761,973)	$ 4,577,427	$ 4,316,081
(Less: Earned Revenue)	(5,600,362)	2,130,748	(3,469,614)	(2,918,217)
Net Program Costs	$ 739,038	$ 368,775	$ 1,107,813	$ 1,397,864
Supply Management				
Intragovernmental	$ 7,780,767	$ (2,240,135)	$ 5,540,632	$ 5,139,686
With the Public	5,585,903	0	5,585,903	3,345,200
Total Program Cost	$ 13,366,670	$ (2,240,135)	$ 11,126,535	$ 8,484,886
(Less: Earned Revenue)	(9,824,911)	1,727,217	(8,097,694)	(8,260,678)
Net Program Costs	$ 3,541,759	$ (512,918)	$ 3,028,841	$ 224,208
Information Services				
Intragovernmental	$ 62,083	$ (42)	$ 62,041	$ 47,973
With the Public	507,899	0	507,899	500,983
Total Program Cost	$ 569,982	$ (42)	$ 569,940	$ 548,956
(Less: Earned Revenue)	(552,198)	144,185	(408,013)	(369,254)
Net Program Costs	$ 17,784	$ 144,143	$ 161,927	$ 179,702
Total Program Costs				
Intragovernmental	$ 10,669,645	$ (4,002,150)	$ 6,667,495	$ 6,093,205
With the Public	9,606,407	0	9,606,407	7,256,718
Total Program Cost	$ 20,276,052	$ (4,002,150)	$ 16,273,902	$ 13,349,923
(Less: Earned Revenue)	(15,977,471)	4,002,150	(11,975,321)	(11,548,149)
Net Program Costs	$ 4,298,581	$ 0	$ 4,298,581	$ 1,801,774
Net Costs of Operations	$ 4,298,581	$ 0	$ 4,298,581	$ 1,801,774

The accompanying notes are an integral part of the financial statements.
See notes 1 and 19.

Working Capital Fund Consolidating and Combining Statements

Consolidating Statement of Changes in Net Position—Working Capital Fund

For the years ended September 30 ($ in Thousands)

	Depot Maintenance	Supply Management	Information Services
Net Cost of Operations	$ 739,038	$ 3,541,759	$ 17,784
Financing Sources (other than exchange revenues)			
Appropriations Used	8,375	0	0
Imputed Financing *(Note 20)*	106,492	11,244	6,696
Transfers - in	0	73,184	0
Transfers - out	(41,038)	0	(1,928)
Other	(92,576)	0	0
Total Financing Sources (other than Exchange Revenues)	$ (18,747)	$ 84,428	$ 4,768
Net Results of Operations	$ (757,785)	$ (3,457,331)	$ (13,016)
Prior Period Adjustments *(Note 20)*	161,543	(3,625,154)	788
Net Change in Cumulative Results of Operations	$ (596,242)	$ (7,082,485)	$ (12,228)
Change in Net Position	$ (596,242)	$ (7,082,485)	$ (12,228)
Net Position-Beginning of the Period	813,458	15,530,364	(5,915)
Net Position-End of the Period	$ 217,216	$ 8,447,879	$ (18,143)

The accompanying notes are an integral part of the financial statements.
See notes 1 and 20.

Transportation	Component Level	Combined Total	Eliminations	FY 2001 Consolidated Total	FY 2000 Consolidated Total
$ 0	$ 0	$ 4,298,581	$ 0	$ 4,298,581	$ 1,801,777
0	0	8,375	0	8,375	0
0	0	124,432	0	124,432	107,034
0	0	73,184	1,928	71,256	229,402
0	0	(42,966)	(1,928)	(41,038)	(378,445)
0	0	(92,576)	0	(92,576)	389,788
$ 0	$ 0	$ 70,449	$ 0	$ 70,449	$ 347,779
$ 0	$ 0	$ (4,228,132)	$ 0	$ (4,228,132)	$ (1,453,998)
353	0	(3,462,470)	0	(3,462,470)	(1,419,599)
$ 353	$ 0	$ (7,690,602)	$ 0	$ (7,690,602)	$ (2,873,597)
$ 353	$ 0	$ (7,690,602)	$ 0	$ (7,690,602)	$ (2,873,597)
48,289	88,440	16,474,636	0	16,474,636	19,348,233
$ 48,642	$ 88,440	$ 8,784,034	$ 0	$ 8,784,034	$ 16,474,636

The accompanying notes are an integral part of the financial statements.
See notes 1 and 20.

Combining Statement of Budgetary Resources—Working Capital Fund

For the years ended September 30 ($ in Thousands)

	Depot Maintenance	Supply Management	Information Services
BUDGETARY RESOURCES			
Budget Authority	$ 8,375	$ 492,026	$ 11,011
Unobligated Balance - Beginning of Period	(113,527)	25,418	53,680
Net Transfers Prior Year Balance, Actual	0	65,500	0
Spending Authority from Offsetting Collections	5,832,792	8,852,185	584,388
Adjustments	(10,001)	70	0
Total Budgetary Resources	$ 5,717,639	$ 9,435,199	$ 649,079
STATUS OF BUDGETARY RESOURCES			
Obligations Incurred	$ 5,678,347	$ 9,417,709	$ 605,951
Unobligated Balances - Available	39,292	17,490	43,128
Total, Status of Budgetary Resources	$ 5,717,639	$ 9,435,199	$ 649,079
OUTLAYS			
Obligations Incurred	$ 5,678,347	$ 9,417,709	$ 605,951
Less: Spending Authority from Offsetting Collections and Adjustments	(5,832,792)	(8,852,255)	(584,388)
Obligated Balance, Net - Beginning of Period	693,816	2,146,288	20,509
Less: Obligated Balance, Net - End of Period	(720,929)	(2,812,321)	(37,427)
Total Outlays	$ (181,558)	$ (100,579)	$ 4,645

The accompanying notes are an integral part of the financial statements.
See notes 1 and 21.

Transportation	Component Level	FY 2001 Combined Total	FY 2000 Combined Total
$ 0	$ 0	$ 511,412	$ 384,498
1,590	88,440	55,601	512,188
0	0	65,500	207,900
6	0	15,269,371	14,763,644
1,229	0	(8,702)	(777,284)
$ 2,825	$ 88,440	$ 15,893,182	$ 15,090,946
$ 0	$ 0	$ 15,702,007	$ 15,035,345
2,825	88,440	191,175	55,601
$ 2,825	$ 88,440	$ 15,893,182	$ 15,090,946
$ 0	$ 0	$ 15,702,007	$ 15,035,345
(1,235)	0	(15,270,670)	(14,763,644)
8,041	(77,653)	2,791,001	2,806,547
(7,400)	87,639	(3,490,438)	(2,791,001)
$ (594)	$ 9,986	$ (268,100)	$ 287,247

Working Capital Fund Consolidating and Combining Statements

The accompanying notes are an integral part of the financial statements.
See notes 1 and 21.

Combining Statement of Financing—Working Capital Fund

For the years ended September 30 ($ in Thousands)

		Depot Maintenance		Supply Management
BLIGATIONS AND NONBUDGETARY RESOURCES:				
Obligations Incurred	$	5,678,347	$	9,417,709
Less: Spending Authority from Offsetting Collections and Adjustments		(5,832,792)		(8,852,255)
Financing Imputed for Cost Subsidies		106,492		11,244
Transfers-In (Out)		0		0
Total Obligations as Adjusted and Nonbudgetary Resources	$	(47,953)	$	576,698
RESOURCES THAT DO NOT FUND NET COST OF OPERATIONS:				
Change in Amount of Goods, Services, and Benefits Ordered but not yet Received or Provided (Increases)/Decreases	$	95,510	$	(218,164)
Change in Unfilled Customer Orders		204,036		215,929
Costs Capitalized on the Balance Sheet - (Increases)/Decreases		240,375		2,903,187
Financing Sources - Fund Costs of Prior Periods		126,043		0
Total Resources That Do Not Fund Net Costs of Operations	$	665,964	$	2,900,952
COMPONENTS COSTS OF OPERATIONS THAT DO NOT REQUIRE OR GENERATE RESOURCES:				
Depreciation and Amortization	$	80,438	$	57,120
Revaluation of Assets and Liabilities - Increase/(Decrease)		0		3,901
Loss of Disposition of Assets		2,393		0
Total Costs That Do Not Require Resources	$	82,831	$	61,021
FINANCING SOURCES TO BE PROVIDED	$	38,196	$	3,088
NET COST OF OPERATIONS	$	739,038	$	3,541,759

The accompanying notes are an integral part of the financial statements.
See notes 1 and 22.

Information Services	Transportation	FY 2001 Combined Total	FY 2000 Combined Total
$ 605,951	$ 0	$ 15,702,007	$ 15,035,345
(584,388)	(1,235)	(15,270,670)	(14,763,644)
6,696	0	124,432	107,034
(1,928)	0	(1,928)	1,092,348
$ 26,331	$ (1,235)	$ 553,841	$ 1,471,083
$ (51,775)	$ 889	$ (173,540)	$ 290,667
35,750	0	455,715	(126,261)
(2,770)	346	3,141,138	(28,939)
0	0	126,043	(206,522)
$ (18,795)	$ 1,235	$ 3,549,356	$ (71,055)
$ 8,286	$ 0	$ 145,844	$ 146,120
0	0	3,901	0
0	0	2,393	56,739
$ 8,286	$ 0	$ 152,138	$ 202,861
$ 1,962	$ 0	$ 43,246	$ 198,890
$ 17,784	$ 0	$ 4,296,581	$ 1,801,777

The accompanying notes are an integral part of the financial statements.
See notes 1 and 22.

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

Working Capital Fund

Required Supplementary Information

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DoD Intra-governmental Asset Balances ($ Amounts in Thousands)	Treasury Index	Fund Balance with Treasury	Accounts Receivable	Other
Department of Agriculture	12		$134	
Department of Commerce	13		$3	
Department of Justice	15		$340	
Navy General Fund	17		$10,138	
Department of State	19		$522	
Department of the Treasury	20	$556,603	$4	
Army General Fund	21		$7,590	
Department of Veterans Affairs	36		$22	
General Service Administration	47		$297	
National Science Foundation	49		$21	
Air Force General Fund	57		$348,502	$10
Environmental Protection Agency	68		$1	
Department of Transportation	69		$650	
Small Business Administration	73		$2	
National Aeronautics and Space Administration	80		$5,888	
Department of Energy	89		$246	
US Army Corps of Engineers	96		$22	
Other Defense Organizations General Funds	97		$58,642	
Other Defense Organizations Working Capital Funds	97-4930		$21,442	$56,469
Army Working Capital Fund	97-4930.001		$1,195	$805
Navy Working Capital Fund	97-4930.002		$5,568	$36
Totals:		**$556,603**	**$461,229**	**$57,320**

DoD Intra-governmental Entity Liabilities ($ Amounts in Thousands)	Treasury Index	Accounts Payable	Other
Navy General Fund	17	$2,695	
Army General Fund	21	$2,334	
Office of Personnel Management	24		$6,154
Air Force General Fund	57	$59,825	$347,383
Other Defense Organizations General Funds	97	$2,422	
Other Defense Organizations Working Capital Funds	97-4930	$56,969	
Army Working Capital Fund	97-4930.001	$12,724	
Navy Working Capital Fund	97-4930.002	$6,864	
Totals:		**$143,833**	**$353,537**

Intra-governmental Revenue and Related Costs ($ Amounts in Thousands)	Treasury Index	Earned Revenue
Executive Office of the President	11	$27
Department of Agriculture	12	$959
Department of Commerce	13	$5
Department of the Interior	14	$28
Department of Justice	15	$1,969
Navy General Fund	17	$154,434
United States Postal Service	18	$2
Department of State	19	$2,005
Department of the Treasury	20	$42
Army General Fund	21	$310,057
General Service Administration	47	$2,634
National Science Foundation	49	$41
Air Force General Fund	57	$9,021,417
Environmental Protection Agency	68	$2
Department of Transportation	69	$5,759
Small Business Administration	73	$9
National Aeronautics and Space Administration	80	$21,491
Department of Energy	89	$1,603
US Army Corps of Engineers	96	$3
Other Defense Organizations General Funds	97	$993,115
Other Defense Organizations Working Capital Funds	97-4930	$856,614
Army Working Capital Fund	97-4930.001	$10,038
Navy Working Capital Fund	97-4930.002	$159,024
Totals:		**$11,541,278**

DoD Intra-governmental Non-exchange Revenues (Amounts in Thousands)	Treasury Index	Transfers In	Transfers Out
Other Defense Organizations Working Capital Funds	97-4930	$71,256	$41,011
Navy Working Capital Fund	97-4930.002		$27
Totals:		**$71,256**	**$41,038**

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Working Capital Fund

Audit Opinions

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

February 21, 2001

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)

SUBJECT: Endorsement of the Disclaimer of Opinion on the FYs 2001 and 2000 Air Force Working Capital Fund Financial Statements (Project No. D2001 FD-0176)

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General. We delegated to the Air Force Audit Agency (AFAA) the audit of the FYs 2001 and 2000 Air Force Working Capital Fund Financial Statements.[1] Summarized as follows is the AFAA disclaimer of opinion on the FYs 2001 and 2000 Air Force Working Capital Fund Financial Statements, and the results of our review of the AFAA audit. The information provided in this memorandum contains reasons for the AFAA disclaimer. We endorse the disclaimer of opinion expressed by AFAA, dated February 8, 2002.

For FY 2001, Office of Management and Budget policy required that the financial statements, except for the Statement of Budgetary Resources, be prepared on a consolidated basis. Consolidation means that intra-agency transactions are to be eliminated. The Statement of Budgetary Resources was required to be prepared on a combined basis. In a combined statement, component figures are added without eliminating intra-agency transactions. In addition, Office of Management and Budget policy required that the current fiscal year financial statements be presented on a comparative basis with financial statements of the previous fiscal year. Accordingly the AFAA report covers FYs 2001 and 2000.

Disclaimer of Opinion. The AFAA disclaimer of opinion on the FYs 2001 and 2000 Air Force Working Capital Fund Financial Statements, dated February 8, 2002, states that AFAA was unable to express an opinion on the financial statements. We concur with the AFAA disclaimer of opinion. The following deficiencies identified by the Department of the Air Force in the notes to the financial statements preclude an audit opinion.

- The Air Force did not implement the U.S. Government Standard General Ledger at the transaction level.
- The Air Force is unable to implement fully all elements of generally accepted accounting principles for Federal entities and the Office of Management and Budget Bulletin 01-09, "Form and Content of Agency Financial Statements," due to limitations in the financial management processes and systems, including nonfinancial feeder systems and processes.
- The Air Force does not recognize an allowance for estimated uncollectible amounts from another Federal agency.

[1] On January 25, 2002, the General Accounting Office issued a new Government Auditing Standard on organizational independence. The new standard is to be applied on a prospective basis and does not affect the audit work that was ongoing for the FY 2001 financial statements. We will apply the new standard for future audit work and will not delegate the financial statement audit work

Internal Controls. The AFAA did not express an opinion on internal controls but concluded that the internal control structure did not provide reasonable assurance of achieving the internal control objectives described in Office of Management and Budget Bulletin 01-02, "Audit Requirements for Federal Financial Statements."

Compliance With Laws and Regulations. The AFAA did not express an opinion on compliance with laws and regulations that could have a direct and material effect on the financial statements, but identified the following instances of noncompliance. For FY 2001, the financial management systems that support the Air Force Working Capital Fund did not substantially comply with Federal financial management system requirements to (1) maintain adequate subsidiary records for audit trails in Air Force and Defense Finance and Accounting Service financial management systems, (2) implement accounting systems with transaction-driven general ledgers, and (3) provide adequate application controls to critical Air Force feeder systems. The financial management systems that supported the Air Force Working Capital Fund did not substantially comply with Federal accounting standards. The Air Force Working Capital Fund accounting systems did not fully implement the U.S. Government Standard General Ledger at the transaction level for budgetary accounts. Details on the adequacy of internal controls and compliance with laws and regulations are discussed in the AFAA report.

Review of Air Force Audit Agency Work. To fulfill our responsibilities for determining the accuracy and completeness of the independent audit work that AFAA conducted, we reviewed the audit approach, planning, and summary working papers supporting the AFAA report. We found no indication that we could not rely on the AFAA disclaimer of opinion or its related evaluation of internal controls and compliance with laws and regulations.

Thomas F. Gimble
Acting
Deputy Assistant Inspector General
for Auditing

DEPARTMENT OF THE AIR FORCE
WASHINGTON DC 20330-1000

OFFICE OF THE SECRETARY

8 February 2002

To the Secretary of the Air Force
Chief of Staff, USAF

We were engaged to audit the Air Force Working Capital Fund financial statements for the fiscal years ended 30 September 2000 and 2001.[1] The annual financial statements consist of the Balance Sheet and related Statement of Net Cost, Statement of Change in Net Position, Statement of Budgetary Resources, and Statement of Financing. Preparation of the financial statements is the responsibility of the Defense Finance and Accounting Service and Air Force management. This report presents our independent opinion on the financial statements, evaluation of the effectiveness of internal controls over financial reporting, and assessment of compliance with laws and regulations.

OPINION ON THE FINANCIAL STATEMENTS

We were not able to obtain sufficient evidential matter, or to apply other auditing procedures, to satisfy ourselves as to the fairness of the Air Force Working Capital Fund financial statements. Therefore, in accordance with Government Auditing Standards and the provisions of Office of Management and Budget (OMB) Bulletin 01-02, Audit Requirements for Federal Financial Statements, 16 October 2000, we are unable to express, and we do not express, an opinion on the reliability of the Air Force Working Capital Fund financial statements for the fiscal years ended 30 September 2000 and 2001. As a result of our inability to audit, we concluded the amounts reported in the consolidated financial statements and related notes may not provide reliable information for government and public decision-making purposes.

We base our disclaimer on the inability of Air Force and Defense Finance and Accounting Service (DFAS) to correct previously reported material deficiencies that affect the reliability of the Air Force Working Capital Fund Fiscal Years (FY) 2000 and 2001 financial statements. The Air Force and DFAS continue their efforts to improve financial reporting; however, the financial systems and processes, as well as the associated internal control structure, remain inadequate to produce reliable financial information. For example:

- Air Force supply management systems still did not provide sufficient audit trails to confirm and value the In-Transit Inventory reported as part of Inventory Held for Sale on the Balance Sheet.
- Air Force depot maintenance systems lacked a transaction-driven general ledger supported by appropriate subsidiary ledgers and special journals. Also, the depot maintenance systems did not perform percentage-of-completion accounting or properly account for Cost of Goods Sold and Work-in-Process.

[1] Management presented consolidated comparative Fiscal Years 2000 and 2001 financial statements as of 30 September 2001. Consequently, in accordance with Government Auditing Standards, our review covered the periods presented and we expressed a disclaimer on the financial statements taken as a whole.

- The Air Force Working Capital Fund Property, Plant, and Equipment valuation continued to be unverifiable.
- The Air Force Working Capital Fund general ledger was inconsistent with the U.S. Government Standard General Ledger.

MANAGEMENT'S DISCUSSION AND ANALYSIS (OVERVIEW)

The information presented in the Overview Section accompanying the Air Force Working Capital Fund financial statements, though not a required part of the principal financial statements, is supplementary information required by OMB Bulletin No. 01-09, Form and Content of Agency Financial Statements. We express no opinion on the Overview information because we did not apply all auditing procedures prescribed by professional standards since the information reported derives from the same data source as the financial statements and, as such, may not be reliable.

REQUIRED SUPPLEMENTARY INFORMATION

The Air Force and DFAS did not present deferred maintenance as Required Supplementary Information. The Financial Accounting Standards Advisory Board determined deferred maintenance should supplement, though not be part of, the principle financial statements.

MANAGEMENT ACTIONS

The Air Force and DFAS continue actions to improve Air Force Working Capital Fund financial data accuracy and reporting. Examples of ongoing initiatives that should contribute to this goal are discussed below. During future audits, we will evaluate the effectiveness of these actions.

- In the supply management area, Air Force and DFAS personnel are redesigning current supply management logistics and accounting systems to correct inventory financial reporting deficiencies. Specifically, the Air Force established a program management office to evaluate and direct changes in business practices and inventory systems to comply with generally accepted accounting principles for reparable inventory assets. For example, the Program Management Office directed system changes for valuing inventory based on historical cost. The Air Force and DFAS anticipate completing these efforts during FY 2003.
- In the depot maintenance area, the Air Force continues efforts to implement depot maintenance system corrections that will provide audit trails and comply with federal financial accounting requirements. When implemented, the depot maintenance systems should (a) provide an automated transaction-driven general ledger that complies with the U.S. Government Standard General Ledger, (b) perform budgetary accounting, (c) maintain subsidiary support for account balances, (d) recognize revenue using the percentage-of-completion methodology, and (e) properly capture depot maintenance costs. The Air Force plans to implement these changes during FY 2003.
- The Air Force and DFAS have initiatives underway to implement the U.S. Government Standard General Ledger in the Air Force Working Capital Fund accounting systems including the Consolidated Reporting System II.[2] The estimated completion date for these initiatives is FY 2003.

We believe these efforts are steps in the right direction and will help to resolve many of the problems with existing systems.

[2] The Consolidated Reporting System II will consolidate the trial balances from various Defense Working Capital Fund departmental financial reporting systems into one consolidated departmental trial balance accounting system.

REPORT ON INTERNAL CONTROLS

Management is responsible for establishing and maintaining an internal control structure to provide reasonable, but not absolute, assurance that transactions are properly recorded, processed, and summarized to (a) permit financial statement preparation in accordance with generally accepted accounting standards; and (b) safeguard assets against loss from unauthorized acquisition, use, or disposal. Because of inherent limitations in any internal control, errors or fraud may nevertheless occur and not be detected. Also, projecting internal control evaluation results to future periods is subject to the risk that procedures may become inadequate. In addition, our consideration of internal controls would not necessarily disclose all material weaknesses. Auditing standards define a material weakness as a condition where controls do not reduce to a relatively low level the risk that errors or irregularities, in amounts that would be material in relation to the financial statements, may occur and not be detected on a timely basis by employees performing their assigned functions. Reportable conditions involve matters coming to our attention that relate to significant deficiencies in the design or operation of the internal control structure over financial reporting that, in our judgment, could adversely affect the Air Force's ability to record, process, summarize, and report Working Capital Fund financial data.

Over the last 10 years, we identified numerous findings and made recommendations to improve internal controls related to financial reporting for the Air Force Working Capital Fund. Although progress occurred in several areas to correct these previously identified problems, a significant number of corrective actions are still in progress. Appendix I identifies prior audit reports, and the material weaknesses addressed in these reports, that remained open during FY 2001.

Furthermore, although we accomplished internal control testing, our financial statement audit objectives did not include providing a separate internal control opinion; accordingly, we do not express such an opinion. However, OMB Bulletin 01-02 requires that we describe material weaknesses and reportable conditions identified during the audit. Therefore, the following paragraphs summarize material weaknesses and reportable conditions that existed in the design or operation of the internal control structure over financial reporting in effect at 30 September 2001. Based on these weaknesses, we determined the internal control structure did not provide reasonable assurance of achieving the internal control objectives described in the OMB bulletin. Report of Audit F2002-0003-C06800, Internal Controls Related to the Fiscal Year 2001 Air Force Working Capital Fund Financial Statements, 30 January 2002, summarizes the material weaknesses and reportable conditions presented below and cites supporting reports performed in accordance with Government Auditing Standards.

RECONCILIATION

Air Force and DFAS personnel did not perform reconciliation and systems validations to verify the accuracy of foreign military sales Accounts Receivable, Progress Payments to Contractors, and Materiel Support Division Accounts Payable. Specifically:

- Air Force and DFAS had not implemented internal controls to validate foreign military sales Accounts Receivable balances. Therefore, we were not able to validate Accounts Receivable balances totaling approximately $556 million (absolute value) as of 30 June 2001. A previous Air Force Audit Agency report identified related problems with inadequate support for prices, resulting in overstated sales accounts.[3] Both DFAS and Air Force Materiel Command personnel are working to

[3] Air Force Audit Agency (AFAA) Report of Audit 99062008, Reduced-Price Foreign Military Sales and Related Grant Transactions, 28 March 2000.

establish an accurate prior-year baseline (as of 30 September 2000) and monthly reconciliation procedures between the Financial Inventory Accounting and Billing System (FIABS)[4] and the Security Assistance Management Information System (SAMIS).[5]

- DFAS accounting technicians did not perform end-of-month reconciliations between the FIABS and Central Procurement Accounting System (CPAS)[6] to validate the Progress Payments to Contractors balances totaling about $118.9 million as of 30 June 2001.

- Supply management personnel did not perform required reviews and reconciliations of dormant Materiel Support Division accounts at closing air logistics centers. Specifically, 16 ($9.4 million) of 29 ($17.6 million) CPAS undelivered orders outstanding were invalid or did not match unliquidated obligation balances recorded in the payment system.

SUPPORTING DOCUMENTATION

Air Force Working Capital Fund resource managers did not always maintain adequate documentation or use transaction subsidiary ledgers and special journals to support recorded trial balance accounts. Specifically:

- Wholesale supply personnel recorded liabilities and corresponding expenses in the Defense Business Management System (DBMS)[7] without supporting documentation to verify actual receipt of goods or services. Specifically, receiving report or certificate of service documentation was not available for 108 ($61.1 million) of 150 ($116.7 million) sampled items because personnel did not routinely request documentation before establishing liabilities and expenses.

- Wholesale supply personnel did not maintain supporting documentation for 85 ($63.9 million) of 150 ($116.7 million) wholesale supply overhead obligation balances recorded in DBMS.

- Air logistics center personnel did not (a) maintain documentation sufficient to support the total military personnel budget ($2.5 million), (b) properly compute budgeted military personnel costs, or (c) capture actual military personnel costs. In addition, these officials did not identify and record in accounting records the variance between budgeted and actual military personnel costs. Although the budgeted amount is not material, the deficiencies identified are significant internal control issues.

- Air Force Working Capital Fund personnel did not use transaction subsidiary ledgers or special journals to support wholesale supply trial balance accounts. Specifically, an analysis of the 31 May 2001 trial balance accounts revealed 25 of 60

[4] FIABS, the original accounting system for Wholesale Supply, compiles transaction data received from logistics feeder systems and debits or credits individual transaction values to an existing General Ledger Account balance.

[5] SAMIS provides the Air Force Security Assistance Center and financial management personnel with information to manage the security assistance programs. Its functions include preparing quarterly billing reports, reimbursements, vouchers, and various management products.

[6] CPAS is an on-line, transaction-processing management and accounting system that controls the program, budget, and fund authorizations for HQ Air Force Materiel Command allocation of central procurement appropriations.

[7] DBMS is the accounting system used by the Air Force Materiel Command to capture and report Supply Management Activity Group wholesale overhead costs.

Air Force Working Capital Fund Undelivered Orders Outstanding, Accounts Payable, Unfilled Customer Orders, Accounts Receivable, and Revenue general ledger accounts contained discrepancies totaling $750.4 million between feeder systems and the Air Force trial balance values. In addition, Air Force and DFAS personnel could not provide an individual transaction database that reconciled to the end of month trial balance cumulative values for Undelivered Orders Outstanding, Accounts Payable, Unfilled Customer Orders, and Accounts Receivable accounts. As a result of the substantial differences between the wholesale supply accounting system and the trial balances for these four accounts, management could not rely upon the accuracy of the reported value of these accounts to make decisions affecting wholesale supply operations. Currently, efforts are underway to accumulate and consolidate individual transaction data from the FIABS into the Standard Materiel Accounting System that would provide the subsidiary ledgers or specialized journals needed to support cumulative general ledger account balances. Air Force Working Capital Fund officials anticipate completing this process in FY 2004 or FY 2005.

- Standard Systems Group (SSG) financial management personnel did not comply with internal control procedures for establishing and liquidating Information Services Activity Group Accounts Payable liabilities. Specifically, SSG personnel established Accounts Payable liabilities without obtaining receiving reports indicating the government actually received the goods or services. Therefore, we could not validate SSG Accounts Payable balances totaling $6.5 million as of 10 August 2001.

ACCOUNT VERIFICATION AND VALIDATION

Air Force personnel did not implement internal controls for account verification and validation when they regionalized the Supply Management Activity Group (SMAG) duties and responsibilities. Specifically, personnel did not validate Unfilled Customer Orders or General Support Division and Material Support Division Accounts Payable and Undelivered Orders Outstanding for 53 ($749 thousand) of 3,058 ($69.2 million) sampled transactions. Additionally, supply personnel did not review or validate any of the Fuels Accounts Payable balances totaling $126 million as of 30 September 2001.

FUND MANAGEMENT PROCEDURES

Fund managers did not receive sufficient information to effectively perform their duties. Specifically, resource advisors and fund holders were unable to conduct adequate reconciliation to verify the accuracy of Accounts Payable charged against their funds because they were not provided copies of receiving reports.

INFORMATION SYSTEM ACCESS

Air Force Materiel Command financial system security managers could improve their control over personnel access to the wholesale supply logistics and accounting systems. Specifically, 3 of 20 individuals reviewed retained access to the Wholesale and Retail Receiving and Shipping System (D035K)[8] and the CPAS when their official duties no longer required access.

CUT-OFF CONTROLS

DFAS officials could not assure accounting personnel recorded collection and disbursement transactions in the proper accounting period. Specifically, four of seven DFAS field locations had not implemented detailed end-of-period cut-off controls or procedures.

[8] D035K is an on-line system whose functions include computing retail requirements; maintaining, cataloging, and managing control data; and recording material receiving, storing, and inventory information.

CUSTODY AND PHYSICAL SECURITY CONTROLS

DFAS activities did not consistently adhere to custody and physical security control procedures at 4 of 11 locations reviewed. The specific weaknesses included improper appointment of disbursing officers, inadequate accountability on deposit tickets, and insufficient physical security involving alarm systems, vaults, safes, keys, and disbursing office configuration.

PERFORMANCE MEASURES

Based on our understanding of the design of internal controls relating to program and financial performance measures reported in the Overview Section of the Air Force Working Capital Fund financial statements, we did not identify any control weaknesses relating to the program performance measures. However, given the internal control weaknesses with respect to financial reporting, financial performance results may be misstated.

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

Air Force management is responsible for complying with laws and regulations applicable to the Air Force Working Capital Fund. Issues that should concern management include compliance with laws and regulations pertaining to the objectives of Air Force Working Capital Fund programs, and the activities, functions, and manner in which programs and services are delivered. Material instances of non-compliance are failures to follow requirements or violations of prohibitions contained in laws or regulations that cause us to conclude the aggregation of the misstatements resulting from those failures or violations is material to the financial statements, or the sensitivity of the matter would cause others to perceive the misstatements as significant.

To obtain reasonable assurance that financial statements are free of material misstatement, we tested Air Force compliance with certain laws and regulations where noncompliance could have a direct and material effect on financial statement amounts. These laws and regulations include requirements contained in the Federal Financial Management Improvement Act and Federal Managers' Financial Integrity Act. Our financial statement audit objectives did not include providing a separate opinion on overall compliance with laws and regulations and, accordingly, we do not express such an opinion.

FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT

Under the Federal Financial Management Improvement Act of 1996, we are required to report whether the agency's financial management systems substantially comply with federal financial management systems requirements, federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. Our follow-up audit work confirmed that previously reported issues continued to exist during FY 2001. Below, we address the instances of non-compliance with the three Federal Financial Management Improvement Act requirements and describe the details related to the specific weaknesses, along with recommended corrective actions, timeframes for corrective actions, and management comments, in the cited reports.

a. Federal Financial Management System Requirements. For FY 2001, the financial management systems that support the Air Force Working Capital Fund did not substantially comply with federal financial management system requirements to (1) maintain adequate subsidiary records for audit trails in Air Force and DFAS financial management systems; (2) implement accounting systems with transaction-driven general ledgers; and (3) provide adequate application controls, such as separation of duties, support for transactions, transaction controls, and data reconciliation, to critical Air Force feeder systems. In addition, due to significant application control weaknesses in the accounting and feeder systems, neither the DFAS nor the Air Force could ensure the systems properly recorded, processed, and summarized only valid transactions and provided accurate information. During the FY 2001 reporting period, the financial management systems continued to contain reportable conditions, such as inadequate access controls, insufficient audit trails and data verification/reconciliation processes, and inadequate system documentation. These weaknesses increased the risk for fraud, errors, and material misstatements to occur within the system and the resulting financial statements. The Air Force and DFAS have acknowledged many of the system weaknesses and reported them in their FY 2001 annual assurance statements on internal management controls. To address these control weaknesses, the Air Force and DFAS are eliminating or replacing non-compliant legacy systems, modifying existing systems, and changing business practices to correct previously identified control deficiencies.

b. Federal Accounting Standards. For FY 2001, the financial management systems that supported the Air Force Working Capital Fund did not substantially comply with federal accounting standards. Specifically:

(1) SFFAS No. 1, Accounting for Selected Assets and Liabilities. The Depot Maintenance Activity Group (DMAG) recognized depot maintenance cost of goods and services sold at estimated amounts instead of actual amounts. (Report of Audit 98068038, Contract Depot Maintenance Financial Processing, Depot Maintenance Activity Group, Air Force Working Capital Fund, Fiscal Year 1998, 12 July 1999)

(2) SFFAS No. 3, Accounting for Inventory and Related Property. The DMAG recorded the value of operating materials and supplies at current stock list prices instead of historical cost. (Report of Audit 98068038, Contract Depot Maintenance Financial Processing, Depot Maintenance Activity Group, Air Force Working Capital Fund, FY 1998, 12 July 1999)

(3) SFFAS No. 6, Accounting for Property, Plant, and Equipment. Air Force and DFAS personnel did not account for government-furnished equipment provided to depot maintenance contractors at no cost to the DMAG. (Report of Audit 98068038, Contract Depot Maintenance Financial Processing, Depot Maintenance Activity Group, Air Force Working Capital Fund, Fiscal Year 1998, 12 July 1999)

(4) SFFAS No. 7, Accounting for Revenue and Other Financing. The DMAG recorded revenue based on completed units instead of the percentage-of-completion method. (Memorandum Report 98068006, Depot Maintenance Activity Group, Air Force Working Capital Fund, 12 March 1999; and Report of Audit 98068038, Contract Depot Maintenance Financial Processing, Depot Maintenance Activity Group, Air Force Working Capital Fund, Fiscal Year 1998, 12 July 1999).

As disclosed in the financial statement footnotes, the financial management systems contain several departures from federal accounting standards. The Air Force has put forth significant effort to solve these problems but will require several years to achieve substantial progress.

c. U.S. Government Standard General Ledger at the Transaction Level. For FY 2001, the Air Force Working Capital Fund accounting systems had not fully implemented the U.S. Government Standard General Ledger at the transaction level for budgetary accounts. Therefore, instead of using budgetary accounts to prepare the Report of Execution, the DFAS-Denver Center continued to rely on proprietary and statistical accounts and data not recorded in the accounting records. As a result, the amounts presented in the Statement of Budgetary Resources and the Statement of Financing were not auditable. (FY 2001 Air Force Working Capital Fund Financial Statement Note 1; and Office of the Inspector General, Department of Defense, Report No. D-2001-163, Accounting Entries Made in Compiling the FY 2000 Financial Statements for the Working Capital Funds of the Air Force and Other Defense Organizations, 26 July 2001)

Working Capital Fund

The DFAS plans to incorporate the U.S. Government Standard General Ledger in the Air Force Working Capital Fund accounting systems including the Consolidated Reporting System II. In addition, the Air Force plans to implement the U.S. Government Standard General Ledger in the Contract Maintenance Accounting and Production System. The Air Force and DF AS estimate these efforts will be completed during FY 2003.

FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT

With respect to management's disclosure of internal control material weaknesses in the DFAS and Air Force Working Capital Fund Federal Managers' Financial Integrity Act reports, we did not identify any material weaknesses related to financial reporting not previously reported.

OBJECTIVE, SCOPE, AND METHODOLOGY

Management is responsible for:

- Preparing the annual financial statements in conformity with applicable accounting principles.
- Establishing and maintaining internal controls and systems to provide reasonable assurance that the control objectives of OMB Bulletin 01-02 are met.
- Complying with applicable laws and regulations.

The AFAA is responsible for:

- Planning and performing an audit to obtain reasonable assurance about whether the principal financial statements are reliable (free of material misstatement) and presented fairly in conformity with OMB Bulletin 01-09, Form and Content of Agency Financial Statement, 25 September 2001.
- Obtaining reasonable assurance about whether relevant management internal controls are in place and operating effectively.
- Testing management's compliance with selected provisions of laws and regulations and performing limited procedures to test the consistency of other information presented in the annual financial statement with the consolidated financial statements.

To fulfill these responsibilities, we:

- Examined, on a test basis, evidence supporting the amounts recorded in the general ledger accounts.
- Assessed the accounting principles used and significant estimates made by management.
- Tested compliance with selected provisions of laws and regulations.
- Obtained an understanding of the design of internal controls, determined whether they have been placed in operation, assessed control risk, and performed tests of the reporting entity's internal controls.
- Followed up on previously reported deficiencies.

In reviewing the Air Force Working Capital Fund consolidated financial statements, we evaluated internal controls to determine the reliability of financial and performance reporting related to the principal statements, accompanying footnotes, and performance measures.

In the area of financial reporting, we determined whether Air Force and DFAS personnel properly recorded, processed, and summarized transactions to permit the preparation of financial statements in accordance with federal accounting standards. We also (a) evaluated the safeguarding of assets against loss from unauthorized acquisition, use, or disposition; (b) obtained an understanding of the design of internal controls; (c) determined whether they were in operation; (d) assessed control risk; and (e) tested controls.

We obtained an understanding of internal control designs related to the existence and completeness of assertions regarding the performance measures included in the overview accompanying the Air Force Working Capital Fund financial statements. We believe our audit work provides a reasonable basis for our audit disclaimer.

We accomplished the audit from April to December 2001 at the Office of the Secretary of the Air Force, Financial Management and Comptroller; DFAS locations (DFAS centers and field organizations); HQ Air Force Materiel Command; and Air Force active duty units. We provided a draft of this report to management in January 2002.

SUMMARY OF PRIOR AUDIT COVERAGE

The General Accounting Office (GAO), DoDIG, and AFAA have conducted multiple reviews related to financial management issues. We issued a disclaimer for our FY 2000 Air Force Working Capital Fund Financial Statements review (Report of Audit 00068004, Opinion on Fiscal Year 2000 Air Force Working Capital Fund Financial Statements, 1 March 2001). The GAO reports can be accessed over the Internet at http://www.gao.gov; DoDIG reports at http://www.dodig.osd.mil; and AFAA reports at http://www.afaa.af.mil.

We appreciate the cooperation and courtesies extended to our auditors.

EARL J. SCOTT
The Deputy Auditor General

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The U.S. Air Force Annual Financial Statement is available for viewing on the Internet at www.saffm.hq.af.mil/FMP/cfo.html.