Principal Financial Statements and Notes

The principal financial statements included in this report have been prepared in accordance with the requirements of the Chief Financial Officers Act of 1990 (P.L. 101-576), the Government Management Reform Act of 1994 and the Office of Management and Budget's (OMB) Bulletin 01-09, "Form and Content of Agency Financial Statements." The responsibility for the integrity of the financial information included in these statements rests with management of the U.S. Department of Defense. The Department's fiscal years 2004 and 2003 principal financial statements were audited by the Office of Inspector General. The auditors' report accompanies the principal statements.

The Department's principal financial statements for fiscal years 2004 and 2003 consisted of the following:

The **Consolidated Balance Sheet**, which present as of September 30, 2004 and 2003 those resources owned or managed by DoD which are available to provide future economic benefits (assets); amounts owed by DoD that will require payments from those resources or future resources (liabilities) and residual amounts retained by DoD, comprising the difference (net position).

The **Consolidated Statement of Net Cost**, which present the net cost of DoD operations for the years ended September 30, 2004 and 2003. DoD's net cost of operations includes the gross costs incurred by DoD less any exchange revenue earned from DoD activities.

The **Consolidated Statement of Changes in Net Position**, which present the change in DoD's net position resulting from the net cost of DoD operations, budgetary financing sources other than exchange revenues and other financing sources for the years ended September 30, 2004 and 2003.

The **Combined Statement of Budgetary Resources**, which present the budgetary resources available to DoD during FY 2004 and 2003, the status of these resources at September 30, 2004 and 2003, and the outlay of budgetary resources for the years ended September 30, 2004 and 2003.

The **Combined Statement of Financing**, which reconcile the net cost of operations with the obligation of budgetary resources for the years ended September 30, 2004 and 2003.

The **Consolidated Statement of Custodial Activity**, which present the sources and disposition of nonexchange revenues collected or accrued by DoD on behalf of other recipient entities for the years ended September 30, 2004 and 2003.

Limitations of Financial Statements. The following limitations apply to the preparation of the fiscal year 2004 financial statements:

The principal financial statements have been prepared to report the financial position and results of operations of the Department of Defense, pursuant to the requirements of 31 U.S.C. 3515 (b). The statements are prepared from the books and records of the Department in accordance with OMB Bulletin 01-09 and to the extent possible generally accepted accounting principles. 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.

The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

Department of Defense
Agency Wide
CONSOLIDATED BALANCE SHEET
As of September 30, 2004 and 2003
($ in Millions)

	2004 Consolidated	2003 Consolidated Restated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Entity	$ 287,685.5	$ 251,544.1
Non-Entity Seized Iraqi Cash	113.4	278.1
Non-Entity-Other	1,800.0	239.8
Investments (Note 4)	231,069.7	205,376.0
Accounts Receivable (Note 5)	1,118.3	1,066.6
Other Assets (Note 6)	1,011.9	105.0
Total Intragovernmental Assets	$ 522,798.8	$ 458,609.6
Cash and Other Monetary Assets (Note 7)	$ 2,178.1	$ 1,534.9
Accounts Receivable (Note 5)	7,427.8	7,299.9
Loans Receivable (Note 8)	70.7	64.0
Inventory and Related Property (Note 9)	213,219.4	205,544.6
General Property, Plant and Equipment (Note 10)	440,898.6	446,308.9
Investments (Note 4)	406.5	217.8
Other Assets (Note 6)	21,486.3	21,729.6
TOTAL ASSETS	$ 1,208,486.2	$ 1,141,309.3
LIABILITIES (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	$ 1,888.4	$ 101.4
Debt (Note 13)	591.8	698.2
Environmental Liabilities (Note 14)	0.0	0.0
Other Liabilities (Note 15 & Note 16)	10,726.9	9,739.1
Total Intragovernmental Liabilities	$ 13,207.1	$ 10,538.7
Accounts Payable (Note 12)	$ 28,309.0	$ 27,863.8
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	1,569,704.7	1,429,565.5
Environmental Liabilities (Note 14)	64,367.2	61,490.6
Loan Guarantee Liability (Note 8)	34.4	25.9
Other Liabilities (Note 15 and Note 16)	34,491.2	30,154.0
Debt Held by Public	0.0	0.0
TOTAL LIABILITIES	$ 1,710,113.6	$ 1,559,638.5
NET POSITION		
Unexpended Appropriations (Note 18)	$ 243,813.9	$ 218,869.5
Cumulative Results of Operations	(745,441.3)	(637,198.7)
TOTAL NET POSITION	$ (501,627.4)	$ (418,329.2)
TOTAL LIABILITIES AND NET POSITION	$ 1,208,486.2	$ 1,141,309.3

Department of Defense

Agency Wide

CONSOLIDATED STATEMENT OF NET COST

For the periods ended September 30, 2004 and 2003

($ in Millions)

	2004 Consolidated	2003 Consolidated
Program Costs		
Intragovernmental Gross Costs	$ 23,574.5	$ 11,748.3
(Less: Intragovernmental Earned Revenue)	(15,429.0)	(13,239.0)
Intragovernmental Net Costs	$ 8,145.5	$ (1,490.7)
Gross Costs With the Public	619,573.8	526,288.4
(Less: Earned Revenue From the Public)	(22,354.4)	(12,507.1)
Net Costs With the Public	$ 597,219.4	$ 513,781.3
Total Net Cost	$ 605,364.9	$ 512,290.6
Cost Not Assigned to Programs	0.0	0.0
(Less: Earned Revenue Not Attributable to Programs)	0.0	0.0
Net Cost of Operations	$ 605,364.9	$ 512,290.6

Department of Defense
Agency Wide
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the periods ended September 30, 2004 and 2003
($ in Millions)

	2004 Consolidated	2003 Consolidated Restated
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ (621,610.7)	$ (946,947.7)
Prior period adjustments (+/-)		
Prior Period Adjustments - Restated (+/-)	(15,588.0)	10,534.8
Beginning Balance, Restated	(637,198.7)	(936,412.9)
Prior Period Adjustments - Not Restated (+/-)	699.5	383,074.9
Beginning Balances, as adjusted	(636,499.2)	(553,338.0)
Budgetary Financing Sources:		
Appropriations received	0.0	0.0
Appropriations transferred-in/out (+/-)	0.0	0.0
Other adjustments (rescissions, etc) (+/-)	0.0	(13.0)
Appropriations used	478,621.1	431,548.0
Nonexchange revenue	1,469.7	931.2
Donations and forfeitures of cash and cash equivalents	7.0	24.4
Transfers-in/out without reimbursement (+/-)	10,568.6	1,329.2
Other budgetary financing sources (+/-)	4,511.5	(2,867.4)
Other Financing Sources:		
Donations and forfeitures of property	0.4	4.6
Transfers-in/out without reimbursement (+/-)	(2,848.6)	(6,702.1)
Imputed financing from costs absorbed by others	4,092.5	3,866.9
Other (+/-)	0.6	308.1
Total Financing Sources	496,422.8	428,429.9
Net Cost of Operations (+/-)	605,364.9	512,290.6
Ending Balances	$ (745,441.3)	$ (637,198.7)

Department of Defense
Agency Wide
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the periods ended September 30, 2004 and 2003
($ in Millions)

	2004 Consolidated	2003 Consolidated Restated
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$ 192,955.8	$ 177,282.6
Prior period adjustments (+/-)		
Prior Period Adjustments - Restated (+/-)	25,913.7	0.0
Beginning Balance, Restated	218,869.5	177,282.6
Prior Period Adjustments - Not Restated (+/-)	0.0	0.0
Beginning Balances, as adjusted	218,869.5	177,282.6
Budgetary Financing Sources:		
Appropriations received	512,194.5	477,036.7
Appropriations transferred-in/out (+/-)	485.6	1,217.8
Other adjustments (rescissions, etc) (+/-)	(9,114.6)	(5,137.1)
Appropriations used	(478,621.1)	(431,530.5)
Nonexchange revenue	0.0	0.0
Donations and forfeitures of cash and cash equivalents	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0
Other budgetary financing sources (+/-)	0.0	0.0
Other Financing Sources:		
Donations and forfeitures of property	0.0	0.0
Transfers-in/out without reimbursement (+/-)	0.0	0.0
Imputed financing from costs absorbed by others	0.0	0.0
Other (+/-)	0.0	0.0
Total Financing Sources	24,944.4	41,586.9
Net Cost of Operations (+/-)		
Ending Balances	$ 243,813.9	$ 218,869.5

Department of Defense
Agency Wide
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2004 and 2003
($ in Millions)

	2004 Combined	2003 Combined
BUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
Budget Authority:		
Appropriations received	$ 582,010.7	$ 546,761.4
Borrowing authority	0.1	0.0
Contract authority	34,855.8	28,109.0
Net transfers (+/-)	(519.3)	1,000.3
Other	0.0	0.0
Unobligated balance:		
Beginning of period	256,659.0	217,722.3
Net transfers, actual (+/-)	782.0	204.3
Anticipated Transfers Balances	0.0	0.0
Spending authority from offsetting collections:		
Earned	0.0	0.0
Collected	146,274.3	135,587.2
Receivable from Federal sources	(79.7)	(714.6)
Change in unfilled customer orders	0.0	0.0
Advance received	360.5	(30.6)
Without advance from Federal sources	980.0	11,000.9
Anticipated for the rest of year, without advances	0.0	0.0
Transfers from trust funds	0.0	0.0
Subtotal	147,535.1	145,842.9
Recoveries of prior year obligations	33,681.9	22,841.9
Temporarily not available pursuant to Public Law	(10.0)	0.0
Permanently not available	(40,338.0)	(33,730.4)
Total Budgetary Resources	$ 1,014,657.3	$ 928,751.7

Department of Defense
Agency Wide
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2004 and 2003
($ in Millions)

	2004 Combined	2003 Combined
STATUS OF BUDGETARY RESOURCES		
Obligations incurred:		
Direct	$ 568,053.7	$ 522,562.4
Reimbursable	152,658.9	147,147.8
Subtotal	720,712.6	669,710.2
Unobligated balance:		
Apportioned	58,631.0	55,052.0
Exempt from apportionment	183,488.1	180,704.3
Other available	0.3	(0.1)
Unobligated Balances Not Available	51,825.3	23,285.3
Total, Status of Budgetary Resources	$ 1,014,657.3	$ 928,751.7
Relationship of Obligations to Outlays:		
Obligated Balance, Net - beginning of period	$ 214,371.9	$ 181,919.4
Obligated Balance transferred, net (+/-)	(14.1)	(23.9)
Obligated Balance, Net - end of period:		
Accounts receivable	(10,136.8)	(10,216.4)
Unfilled customer order from Federal sources	(39,402.0)	(38,422.1)
Undelivered orders	228,801.3	213,597.8
Accounts payable	53,470.6	49,412.6
Outlays:		
Disbursements	667,755.1	604,105.8
Collections	(146,634.7)	(135,556.8)
Subtotal	521,120.4	468,549.0
Less: Offsetting receipts	(46,546.4)	(43,294.0)
Net Outlays	$ 474,574.0	$ 425,255.0

Department of Defense
Agency Wide
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2004 and 2003
($ in Millions)

	2004 Combined	2003 Combined
NONBUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
Budget Authority:		
Appropriations received	$ 0.0	$ 0.0
Borrowing authority	114.6	50.5
Contract authority	0.0	0.0
Net transfers (+/-)	0.0	0.0
Other	0.0	0.0
Unobligated balance:		
Beginning of period	21.8	104.0
Net transfers, actual (+/-)	0.0	0.0
Anticipated Transfers Balances	0.0	0.0
Spending authority from offsetting collections:		
Earned	0.0	0.0
Collected	17.4	56.2
Receivable from Federal sources	(0.6)	(90.0)
Change in unfilled customer orders	0.0	0.0
Advance received	0.0	0.0
Without advance from Federal sources	47.2	35.8
Anticipated for the rest of year, without advances	0.0	0.0
Transfers from trust funds	0.0	0.0
Subtotal	64.0	2.0
Recoveries of prior year obligations	0.0	1.9
Temporarily not available pursuant to Public Law	0.0	0.0
Permanently not available	20.7	(0.2)
Total Budgetary Resources	$ 221.1	$ 158.2

Department of Defense
Agency Wide
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended September 30, 2004 and 2003
($ in Millions)

	2004 Combined	2003 Combined
STATUS OF BUDGETARY RESOURCES		
Obligations incurred:		
Direct	$ 196.6	$ 136.4
Reimbursable	0.0	0.0
Subtotal	196.6	136.4
Unobligated balance:		
Apportioned	1.4	1.3
Exempt from apportionment	0.0	0.0
Other available	0.0	(0.1)
Unobligated Balances Not Available	23.1	20.6
Total, Status of Budgetary Resources	$ 221.1	$ 158.2
Relationship of Obligations to Outlays:		
Obligated Balance, Net - beginning of period	$ 29.9	$ (95.1)
Obligated Balance transferred, net (+/-)	0.0	0.0
Obligated Balance, Net - end of period:		
Accounts receivable	0.0	(0.6)
Unfilled customer order from Federal sources	(83.1)	(35.8)
Undelivered orders	238.8	66.3
Accounts payable	0.0	0.0
Outlays:		
Disbursements	24.1	63.6
Collections	(17.4)	(56.2)
Subtotal	6.7	7.4
Less: Offsetting receipts	0.0	0.0
Net Outlays	$ 6.7	$ 7.4

Department of Defense
Agency Wide
COMBINED STATEMENT OF FINANCING
For the periods ended September 30, 2004 and 2003
($ in Millions)

	2004 Combined	2003 Combined
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 720,909.2	$ 669,846.5
Less: Spending authority from offsetting collections and recoveries (-)	(181,281.0)	(168,688.6)
Obligations net of offsetting collections and recoveries	539,628.2	501,157.9
Less: Offsetting receipts (-)	(46,546.4)	(43,294.0)
Net obligations	493,081.8	457,863.9
Other Resources		
Donations and forfeitures of property	0.4	4.6
Transfers in/out without reimbursement (+/-)	(2,848.6)	(6,702.1)
Imputed financing from costs absorbed by others	4,092.5	3,866.9
Other (+/-)	0.6	308.1
Net other resources used to finance activities	1,244.9	(2,522.5)
Total resources used to finance activities	494,326.7	455,341.4
Resources Used to Finance Items not Part of the Net Cost of Operations		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided		
Undelivered Orders (-)	(13,925.6)	(37,435.1)
Unfilled Customer Orders	1,387.4	11,006.1
Resources that fund expenses recognized in prior periods	(2,637.4)	(686.3)
Budgetary offsetting collections and receipts that do not affect net cost of operations	2,645.4	929.3
Resources that finance the acquisition of assets	(86,943.6)	(72,984.9)
Other resources or adjustments to net obligated resources that do not affect net cost of operations		
Less: Trust or Special Fund Receipts Related to Exchange	(10.0)	0.0
Other (+/-)	2,855.5	6,623.6
Total resources used to finance items not part of the net cost of operations	(96,628.3)	(92,547.3)
Total resources used to finance the net cost of operations	397,698.4	362,794.1

Department of Defense

Agency Wide

COMBINED STATEMENT OF FINANCING

For the periods ended September 30, 2004 and 2003

($ in Millions)

	2004 Combined	**2003 Combined**
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Period:		
Increase in annual leave liability	514.8	662.7
Increase in environmental and disposal liability	3,864.6	2,033.6
Upward/Downward reestimates of credit subsidy expense (+/-)	14.9	0.0
Increase in exchange revenue receivable from the public (-)	(73.8)	(6.6)
Other (+/-)	139,064.9	95,403.2
Total components of Net Cost of Operations that will require or generate resources in future periods	143,385.4	98,092.9
Components not Requiring or Generating Resources:		
Depreciation and amortization	42,249.2	55,274.7
Revaluation of assets or liabilities (+/-)	(5,712.6)	6,299.4
Other (+/-)		
Trust Fund Exchange Revenue	(24,285.4)	(23,792.5)
Cost of Goods Sold	41,421.8	0.0
Operating Material & Supplies Used	4,655.9	0.0
Other	5,952.2	13,622.0
Total components of Net Cost of Operations that will not require or generate resources	64,281.1	51,403.6
Total components of net cost of operations that will not require or generate resources in the current period	207,666.5	149,496.5
Net Cost of Operations	605,364.9	512,290.6

Department of Defense

Agency Wide

COMBINED STATEMENT OF CUSTODIAL ACTIVITY

For the periods ended September 30, 2004 and 2003

($ in Millions)

	2004 Combined	2003 Combined
SOURCE OF COLLECTIONS		
Deposits by Foreign Governments	$ 11,237.5	$ 9,971.6
Seized Iraqi Cash	118.3	808.9
Other Collections	0.0	0.0
Total Cash Collections	$ 11,355.8	$ 10,780.5
Accrual Adjustments (+/-)	$ 0.9	$ 0.7
Total Custodial Collections	$ 11,356.7	$ 10,781.2
DISPOSITION OF COLLECTIONS		
Disbursed on Behalf of Foreign Governments and International Organizations	$ 9,998.8	$ 10,118.8
Seized Assets Disbursed on behalf of Iraqi People	283.1	530.8
Increase (Decrease) in Amounts to be Transferred	1,239.5	(146.5)
Collections Used for Refunds and Other Payments	0.0	0.0
Retained by The Reporting Entity	0.0	0.0
Seized Assets Retained for Support of the Iraqi People	(164.7)	278.1
Total Disposition of Collections	$ 11,356.7	$ 10,781.2
NET CUSTODIAL COLLECTION ACTIVITY	$ 0.0	$ 0.0

Note 1. Significant Accounting Policies

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Department of Defense (DoD), as required by the "Chief Financial Officers Act of 1990," expanded by the "Government Management Reform Act of 1994," and other appropriate legislation. The financial statements have been prepared from the books and records of the Department in accordance with the "DoD Financial Management Regulation," Office of Management and Budget Bulletin No. 01-09, "Form and Content of Agency Financial Statements," and to the extent possible generally accepted accounting principles (GAAP). The accompanying financial statements account for all resources for which the Department is responsible. Information relative to classified assets, programs, and operations has been excluded from the statements or otherwise aggregated and reported in such a manner that it is no longer classified.

The Department is unable to fully implement all elements of GAAP and Office of Management and Budget Bulletin No. 01-09 due to limitations of its financial management processes and systems, including nonfinancial systems and processes that feed into the financial statements. The Department derives its reported values and information for major asset and liability categories largely from nonfinancial systems, known as feeder systems, such as inventory systems and logistic systems. These systems were designed to support reporting requirements that focus on maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with GAAP. The Department continues to implement process and system improvements addressing these limitations.

1.B. Mission of the Reporting Entity

The National Security Act of 1947 established the Department of Defense. The Department's mission is to organize, train, and equip armed forces to deter aggression and, if necessary, defeat aggressors against the United States and its allies. Fiscal Year (FY) 2004 is the ninth year that the Department has prepared audited DOD Agency-wide financial statements as required by the Chief Financial Officers Act and Government Management Reform Act. Auditors are required to audit the financial statements of the following stand-alone reporting entities: (1) Army General Fund, (2) Army Working Capital Fund, (3) Navy General Fund, (4) Navy Working Capital Fund, (5) Air Force General Fund, (6) Air Force Working Capital Fund, (7) Military Retirement Fund, (8) DoD Medicare-Eligible Retiree Health Care Fund, and (9) U.S. Army Corps of Engineers (Civil Works).

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

Also, the Department requires the following Defense Agencies to prepare internal stand-alone annual financial statements to be audited by certified public accounting firms: (1) Defense Logistics Agency, (2) Defense Finance and Accounting Service, (3) Defense Information Systems Agency, (4) Defense Contract Audit Agency, (5) Defense Commissary Agency, (6) Defense Security Service, and (7) Defense Threat Reduction Agency.

1.C. Appropriations and Funds

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

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

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

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

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

Working capital funds (WCF) receive their initial funding through an appropriation or a transfer of resources from existing appropriations or funds and use those capital resources to finance the initial cost of products and services. 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.

1.D. Basis of Accounting

For FY 2004, the Department's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the Department's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of GAAP for federal agencies and, therefore, were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP. Most of the Department's legacy systems were designed to record information on a budgetary basis.

The Department has undertaken efforts to determine the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with all elements of 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 all of the Department's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, the DoD's financial data will be based on budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and adjusted for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities.

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

1.E. Revenues and Other Financing Sources

The Department receives congressional appropriations as financing sources for general funds (annual and a multi-year basis). When authorized, these appropriations are supplemented by revenues generated by sales of goods or services. The Department recognizes revenue as a result of costs incurred or services performed on behalf of other federal agencies and the public. The Department recognizes revenue when earned where systems allow for it. In other instances, revenue is recognized when bills are issued.

The Department does not include non-monetary support provided by U.S. allies for common defense and mutual security in its list of other financing sources that appears in the Statement of Financing. The U.S. has cost-sharing agreements with other countries. Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. fleet is in a port.

1.F. Recognition of Expenses

For financial reporting purposes, the DoD policy requires the recognition of operating expenses in the period incurred. However, because the Department's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, environmental liabilities and unbilled revenue. The Department's expenditures for capital and other long-term assets are recognized as operating expenses based on depreciation. In the case of Operating Materials and Supplies (OM&S), operating expenses are generally recognized when items are either purchased or issued to users. Efforts are underway to migrate towards the consumption method for recognizing OM&S expenses. 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 expensed in the period that payment is made. The Department adjusts operating expenses as a result of the elimination of balances between DoD Components.

1.G. Accounting for Intragovernmental Activities

The Department, 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 Department.

Public Debt

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

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

Inter/Intra Governmental Elimination

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within the Department or between two or more federal agencies. However, the Department cannot accurately identify most of its intragovernmental transactions by customer because DoD's systems do not track buyer and seller data needed to match related transactions. For FY 1999 and beyond, seller entities within the Department provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records have been adjusted to recognize unrecorded costs and accounts payable. Intra-DoD intragovernmental balances were then eliminated. The Department is 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 cannot be accomplished effectively with the existing or foreseeable resources.

The Department of the Treasury Financial Management Service (FMS) is responsible for eliminating transactions between the Department and other federal agencies. In May 2004, the FMS issued the Treasury Financial Manual Part 2 – Chapter 4700 "Agency Reporting Requirements for the Financial Report of the United States Government." The Department is not able to fully implement the policies and procedures in this manual related to reconciling intragovernmental assets, liabilities, revenues, and expenses for nonfiduciary transactions. The Department, however, is 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," which has been updated and reissued on September 24, 2004. Both documents provide guidance for reconciling Intragovernmental transactions pertaining to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor (DoL), and benefit program transactions with the 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 are required to make payments in advance.

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

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

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

1.J. Foreign Currency

Cash is the total of cash resources under the control of the Department of Defense, which includes coin, paper currency, negotiable instruments, and amounts held for deposit in banks and other financial institutions. Cash available for agency use includes petty cash funds and cash held in revolving funds, which will not be transferred into the U.S. Government General Fund. Foreign currency consists of the total U.S. dollar equivalent of both purchased and non-purchased foreign currencies held in foreign currency fund accounts. The majority of cash and all foreign currency is classified as non-entity and, therefore, restricted.

The amounts for cash and foreign currency reported consist primarily of cash held by Disbursing Officers to carry out their paying, collecting and foreign currency accommodation exchange missions. Cash seized during Operation Iraqi Freedom is restricted for use to assist the Iraqi people and support the reconstruction of Iraq.

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

1.K. Accounts Receivable

As presented in the Balance Sheet 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 other Federal agencies. Claims against other Federal agencies are to be resolved between the agencies (per Code of Federal Regulations 4CFR 101.)

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

1.L. Loans Receivable

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

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

1.M. Inventories and Related Property

Most of the Department's inventories are currently reported at an approximation of historical cost using latest acquisition cost adjusted for holding gains and losses. The latest acquisition cost method is used because legacy inventory systems were designed for materiel management rather than accounting. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with SFFAS No. 3, "Accounting for Inventory and Related Property." Additionally, these systems cannot produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). By utilizing new systems development processes, the DoD Components have transitioned, and are continuing to transition, their inventory to the moving average cost method. Upon full implementation, the Department will be compliant with SFFAS No. 3. Approximately 5 percent of inventories are now reported at moving average cost.

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

Related property includes OM&S and stockpile materials. OM&S, including munitions not held for sale, are valued at standard purchase price. The Department uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored, and procured by general fund appropriations such as ammunition and engines, are generally accounted by the consumption method and reported on the balance sheet as OM&S. When current systems cannot fully support the consumption method, the Department uses the purchase method - that is, materials and supplies are expensed when purchased. For FY 2004, the Department expensed significant amounts using the purchase method either because the systems could not support the consumption method or because management deemed that the item is in the hands of the end user.

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

The Department implemented new policy in FY 2002 to account for condemned materiel only, as "Excess, Obsolete, and Unserviceable." The net value of condemned materiel is zero, because the costs of disposal are greater than the potential scrap value. Potentially redistributable materiel, presented in previous years as "Excess, Obsolete, and Unserviceable," is included in "Held for Use" or "Held for Repair" categories according to its condition.

Past audit results identified uncertainties about the completeness and existence of quantities used to produce the reported values of inventory. Inventory available and purchased for resale includes consumable spare and repair parts and repairable items owned and managed by the Department. This inventory is retained to support military or national contingencies. Inventory held for repair is damaged inventory that requires repair to make suitable for sale. It is more economical to repair than to procure these inventory items. Because the Department often relies on weapon systems and machinery no longer in production, the Department supports a process that encourages the repair and rebuilding of certain items. This repair cycle is essential to maintaining a ready, mobile, and armed military force. Finally, work in process balances include costs related to the production or servicing of items, including direct material, direct labor, applied overhead and other direct costs. Work in process also includes the value of finished products or completed services pending the submission of bills to the customer. The work in process designation may also be used to accumulate the amount paid to a contractor under cost reimbursable contracts, including the amount withheld from payment to ensure performance, and the amount paid to other government plants for accrued costs of end items of materiel ordered but not delivered. Work in process includes munitions in production and depot maintenance work with its associated labor, applied overhead, and supplies used in the delivery of maintenance services.

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

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

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

The Department's Net Investments are supported by various Trust Funds in each of the reporting entities. These Trust Funds are comprised of Military Retirement Trust Fund (MRF), Medicare-Eligible Retiree Health Care Fund (MERHCF), Other Defense Organizations General Fund (ODO GF), donations (Gift Funds), and the United States Army Corps of Engineers (USACE).

1.O. General Property, Plant and Equipment

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

General 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, DoD requires capitalization of improvement costs over the DoD capitalization threshold of $100,000 for General PP&E. The Department depreciates all General PP&E, other than land, on a straight-line basis.

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

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

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

Regardless, the Department is developing new policies and a contractor reporting process that will provide appropriate General PP&E information for future financial statement reporting purposes. Accordingly, the Department reports only the government property in the possession of contractors that is maintained in the DoD's property systems. Currently the Department does not plan to show contractor-held property as a separate line-item in Note 10.

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

1.P. Advances and Prepayments

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

1.Q. Leases

Generally, lease payments are for the rental of equipment and operating facilities and are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease), the Department records the applicable asset and liability if the value equals or exceeds the current DoD capitalization threshold. The Department records the amounts as the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor) or the asset's fair market value. The discount rate for the present value calculation is either the lessor's implicit interest rate or the governmental incremental borrowing rate at the inception of the lease. DoD as the lessee receives the use and possession of leased property, for example real estate or equipment, from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all the benefits and risk of ownership. Payments for operating leases are charged to expense over the lease term as it becomes payable.

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

1.R. Other Assets

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

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

1.S. Contingencies and Other Liabilities

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

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

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

1.T. Accrued Leave

The Department reports as liabilities civilian annual leave and military leave that has been accrued and not used as of the balance sheet date. The liability reported at the end of the accounting period reflects the current pay rates.

1.U. Net Position

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

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

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

1.V. Treaties for Use of Foreign Bases

The DoD Components have the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. DoD purchases capital assets overseas with appropriated funds; however, the host country retains title to land and improvements. Generally, treaty terms allow the DoD Components continued use of these properties until the treaties expire. The DoD's fixed assets decrease by not renewing a treaty or not reaching agreements. In the event treaties or other agreements are terminated, whereby use of the foreign bases is prohibited, losses are recorded for the value of any non-retrievable capital assets. This takes place after negotiations between the U.S. and the host country have determined the amount to be paid to the U.S. for such capital investments.

1.W. Comparative Data

Financial statement fluctuations greater than 10 percent are generally explained within the Notes to the Financial Statements.

1.X. Unexpended Obligations

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

1.Y. Problem Disbursements and Collections

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

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

Note 2.	Nonentity Assets

As of September 30		2004		2003
(Amounts in millions)				
1. Intragovernmental Assets				
A. Fund Balance with Treasury	$	1,913.5	$	517.9
B. Accounts Receivable		8.2		2.0
C. Total Intragovernmental Assets	$	1,921.7	$	519.9
2. Nonfederal Assets				
A. Cash and Other Monetary Assets	$	2,079.6	$	1,393.0
B. Accounts Receivable		5,107.7		5,063.4
C. Other Assets		0.6		126.0
D. Total Non-Federal Assets	$	7,187.9	$	6,582.4
3. Total Nonentity Assets	$	9,109.6	$	7,102.3
4. Total Entity Assets	$	1,199,376.6	$	1,134,207.0
5. Total Assets	$	1,208,486.2	$	1,141,309.3

Nonentity assets are assets for which the Department maintains stewardship accountability and responsibility to report, but are not available for use in the operations.

Fluctuations

Nonentity Fund Balance with Treasury (FBWT) increased $1.4 billion (269 percent). The majority of this increase is attributable to collections exceeding disbursements by $1.2 billion for Foreign Military Sales (FMS). The FMS Trust Fund receives funds in advance from foreign customers based on future requirement forecasts. The FMS collections from the foreign customers are based on initial deposit requirements and the quarterly billing statement that forecasts advance cash requirements.

Nonentity intragovernmental accounts receivable increased $6.2 million (310 percent). The fluctuation is attributable to the partial resolution of abnormal account receivable balances. These balances were created by cross-walk problems during the implementation of the Air Force General Funds' General Accounting and Finance System-Rehost (GAFS-R) in FY 2004. Research is on-going to resolve these cross-walk issues.

Cash and other monetary assets increased a net $686.6 million (49 percent). This increase is primarily due to increased support to the Operation Iraqi Freedom and Operation Enduring Freedom.

Intragovernmental Assets

Fund Balance with Treasury

The Nonentity Fund Balance with Treasury is comprised of three elements: Iraqi Custodial Fund, the FMS Trust Fund, and deposit and suspense accounts. The Iraqi Custodial Fund represents Iraqi cash seized by coalition forces during Operation Iraqi Freedom. These funds will be used to support the Iraqi people. Under authority of the Arms Export and Control Act, the FMS Trust Fund receives collections from foreign governments that are dedicated specifically to FMS purchases. The deposit and suspense accounts represent income tax withholding not yet disbursed to the Treasury or to state or local authorities.

Accounts Receivable

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

Non-Federal Assets

Cash and Other Monetary Assets

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

Accounts Receivable

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

Other Assets

Other nonentity assets primarily represent outstanding travel advances for the Air Force General Fund.

Note 3.	Fund Balance with Treasury

As of September 30		2004		2003
(Amounts in millions)				
1. Fund Balances				
A. Appropriated Funds	$	267,067.5	$	238,052.2
B. Revolving Funds		9,036.3		11,131.1
C. Trust Funds		1,955.5		559.0
D. Other Fund Types		11,539.6		2,319.7
E. Total Fund Balances	$	289,598.9	$	252,062.0
2. Fund Balances Per Treasury Versus Agency				
A. Fund Balance per Treasury	$	293,082.2	$	251,682.0
B. Fund Balance per Department of Defense		289,598.9		252,062.0
3. Reconciling Amount	$	3,483.3	$	(380.0)

Reporting Entity (Amounts in millions)		Fund Balance with Treasury FY 2004		Fund Balance per Entity Books FY 2004		Reconciling Amount FY 2004		Reconciling Amount FY 2003
Navy GF	$	83,080	$	82,094	$	986	$	
Air Force GF		61,498		60,601		897		
Army GF		89,549		89,549				
ODO GF		50,263		49,207		1,056		(314)
Corps of Engineers		2,907		2,387		520		(66)
MERHCF		5		5				
MRF		21		21				
Air Force WCF		1,704		1,051		653		1,742
Army WCF		948		948				
ODO WCF		2,246		2,875		(629)		(1,742)
Navy WCF		861		861				
Total	$	**293,082**	$	**289,599**	$	**3,483**	$	**(380)**

Analysis of Reconciling Amounts

For the Defense Agencies, the Department of Defense reconciles at the agency-wide level, since Defense Treasury Index 97 funds allotted at limit level complicate the Department's ability to reconcile at the defense agency level. The Department continues to improve internal methodology to properly account for their funds at the entity level.

The Department of Defense shows a reconciling net difference of $3.5 billion with the Department of the Treasury, which is comprised of:

- $986 million, for the Navy General Fund, that represents receipt account transactions unavailable to the Department of the Navy and canceling appropriated authority withdrawn by the Department of the Treasury at the end of the fiscal year;

- $897 million, for the Air Force General Fund, that represents the preclosing amount of Miscellaneous Receipt Accounts and Canceling Account balances on the entity records and not on the Treasury Trial Balance;

- $1.1billion, for the Other Defense Organizations (ODO) - General Fund, that includes a negative balance of $373.3 million in unsupported undistributed disbursements and collections reported at the departmental level but not yet recorded by the applicable agency. The remaining reconciling balance represents canceling appropriation authority withdrawn by the Department of the Treasury at the end of the fiscal year;

- $520 million that represents receipt accounts closed by the U.S. Army Corps of Engineers. The closure is not yet reflected on the Department of the Treasury report;

- $653 million, for the United States Transportation Command, that is recorded as Fund Balance with Treasury in the Air Force Working Capital Fund. The accounting for these funds is actually performed within the entity books of the ODO Working Capital Fund. For financial reporting, the Fund Balance with Treasury for the ODO Working Capital Fund is adjusted downward to reconcile with the Air Force Working Capital Fund;

- ($629) million which is primarily due to the downward adjustment to the Fund Balance with Treasury for the ODO Working Capital Fund to reflect that the cash reporting to the Department of the Treasury for the United States Transportation Command is done through the Air Force Working Capital Fund.

Other Information Related to Fund Balance with Treasury

Total Fund Balance

Total Fund Balance with Treasury increased approximately $37.5 billion (15 percent). Funding from appropriations increased by approximately $29 billion (12 percent). The increase is primarily attributable to an increase of $25.7 billion in the Army General Fund and $3.5 billion in the Navy General Fund for various purposes such as Operation Enduring Freedom and Operation Iraqi Freedom.

The Army General Fund increase also includes approximately $38.3 million in Vested Iraqi Cash. This cash represents frozen Iraqi deposits in the United States and is vested in accordance with the International Emergency Economic Powers Act, Section 1701, and is used in support of the Iraqi people. Since the beginning of the war, Army has collected $1.7 billion in Vested Iraqi Cash and has disbursed $1.7 billion benefiting the Iraqi people as follows:

	Disbursed ($ in millions)
Iraqi Salaries	$1,184.9
Repair/Reconstruction/Humanitarian Assistance	140.9
Iraqi Ministry Operations (Ministry of Finance, Defense, etc.)	360.0
Total Disbursed	**$1,685.8**

The Trust Funds increased approximately $1.4 billion (250 percent) due primarily to an increase in the ODO - General Fund as a result of Foreign Military Sales Trust Fund Collections exceeding Foreign Military Sales Trust Fund Disbursements.

The Other Fund Types increased approximately $9.2 billion (396 percent) principally due to an $8.9 billion increase in the Iraqi Relief and Reconstruction Fund.

Disclosures Related to Suspense/Budget Clearing Accounts

As of September 30		2002	2003	2004	(Decrease)/ Increase from FY 2003 - 2004
(Amounts in millions)					
Account					
F3875	$	(490.1) $	(628.8) $	(608.5) $	20.3
F3880		(3.8)	(6.0)	(1.4)	4.6
F3882		(37.3)	(21.6)	(59.5)	(37.9)
F3885		(185.0)	(399.5)	(118.2)	281.3
F3886		5.1	0.2	0.2	0.0
Total	$	(711.1) $	(1,055.7) $	(787.4) $	268.3

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

The F3875 and F3885 suspense clearing accounts represent the primary sources of the overall negative balance. Account F3875 reported a negative balance of approximately $608.5 million that represents the Disbursing Officer's (DO) suspense. Account F3885, that includes the Interfund/Intragovermental Paying and Collection (IPAC) suspenses, reported a negative balance of approximately $118.2 million. Account F3886 has a positive balance of approximately $0.2 million represented by the Thrift Savings Plan suspense. These three suspense accounts temporarily hold collections or disbursements until they can be assigned or identified to a valid appropriation.

The F3880 suspense account reported a negative balance of approximately $1.4 million. This amount represents the balance of Treasury checks that (1) have either been lost by the payee and need to be reissued, (2) have never been cashed by the payee, or (3) have been cancelled by the Treasury and need to be transferred to the original appropriation.

The F3882 suspense account reported a negative balance of approximately $59.5 million. This account was established for the Uniformed Services Thrift Savings Plan in FY 2002. The amounts in this account represent a timing difference between the posting of the Thrift Savings Plan deductions by the National Finance Center and the posting of these same amounts in the military accounting systems in the following month.

On September 30 of each fiscal year, most of the uncleared suspense/budget clearing account balances are reduced to zero (as required by the Department of the Treasury) by transferring the balances to appropriation accounts. On October 1 of the following fiscal year, the uncleared suspense/clearing account balances are reestablished.

Under the authority of Section 1009 of Public Law 107-314, "Clearance of Certain Transactions Recorded in Treasury Suspense Accounts and Resolution of Certain Check Issue Discrepancies," the Department of Defense cancelled $414.1 million net and $625.5 million absolute from suspense accounts. The impact on the financial statements of canceling this amount was that this net amount was no longer in suspense and, therefore, was not transferred to appropriation accounts.

Problem Disbursements and In-Transit Disbursements

(Amounts in millions)	September 2002	September 2003	September 2004	(Decrease)/ Increase from 2003 to 2004
1. Total Problem Disbursements				
A. Absolute Unmatched Disbursements	$ 858.0	$ 854.3	$ 734.6	$ -119.7
B. Negative Unliquidated Obligations	122.0	124.9	94.8	-30.1
2. Total In-Transit Disbursements, Net	$ 4,550.0	$ 4,675.5	$ 5,197.8	$ 522.3

The DoD reported $734.6 million (absolute value) in Unmatched Disbursements (UMD), which is a decrease of $119.7 million. A UMD occurs when a payment is not matched to a corresponding obligation in the accounting system. Absolute value is the sum of the positive values of debit and credit transactions without regard to the sign (plus or minus).

The DoD reported $94.8 million (absolute value) in Negative Unliquidated Obligations (NULOs), which is a decrease of $30.1 million. A NULO occurs when a payment is made against a valid obligation, but the payment is greater than the amount of the obligation recorded in the official accounting system. These problem disbursements represent the absolute value of disbursements of DoD funds that have been reported by a disbursing station to the Department of the Treasury. However, these problem disbursements have not yet been precisely matched against the specific source obligation that gave rise to the disbursements. These payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

The DoD reported $5.2 billion (net) for In-Transits, which is an increase of $522.3 million. The In-Transits represent the net value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity and have not been posted to the accounting system.

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

Note 4. Investments and Related Interest

As of September 30	2004					2003
	Cost	Amortization Method	Amortized (Premium/ Discount)	Investments, Net	Market Value Disclosure	Investments, Net
(Amounts in millions)						
1. Intra-governmental Securities:						
A. Non-Marketable, Market-Based	242,578.3	Effective Interest	(15,508.8)	227,069.5	238,639.5	201,741.0
B. Subtotal	$ 242,578.3		$ (15,508.8)	$ 227,069.5	$ 238,639.5	$ 201,741.0
C. Accrued Interest	$ 4,000.2			$ 4,000.2	$ 4,000.2	$ 3,635.0
D. Total Intra-governmental Securities	$ 246,578.5		$ (15,508.8)	$ 231,069.7	$ 242,639.7	$ 205,376.0
2. Other Investments:	$ 406.5		0.0	$ 406.5	N/A	$ 217.8

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

Intragovernmental Securities

Net Investments increased by $25.7 billion (13 percent) in Non-Marketable, Market-Based securities. The increase is primarily due to positive cash flows of $20.1 billion for the Medicare-Eligible Retiree Health Care Fund and $5.4 billion for the Military Retirement Fund.

Other Investments

Other Investments increased $188.7 million (87 percent) due to new investments in limited partnerships by the Army ($93.0 million) and Navy ($95.7 million) to support military housing. A summary of the Department's total investments in these limited partnerships follow:

Installation	Amount Invested	Month Invested
Beaufort/Paris ISL/Quantico	$ 97.2	October 2003
Ft. Campbell, Kentucky	52.2	January 2004
Ft. Hood, Texas	52.0	November 2001
Ft. Bragg, North Carolina	49.4	December 2003
Ft. Stewart, Georgia	37.4	February 2004
South Texas, Texas	29.4	February 2002
Honolulu, Hawaii	25.0	May 2004
New Orleans Naval Complex, Louisiana	23.1	October 2001
San Diego, California	20.9	June 2003
Everett NAS, Washington	12.2	December 2000
Kingsville NAS, Texas	4.3	December 2000
Ft. Hamilton, New York	2.2	May 2004
Ft. Detrick, Maryland	1.3	September 2004
	406.5	

Note 5. Accounts Receivable

As of September 30	2004			2003
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
(Amounts in millions)				
1. Intra-governmental Receivables:	$ 1,118.3	N/A	$ 1,118.3	$ 1,066.6
2. Non-Federal Receivables (From the Public):	$ 8,028.3	$ (600.5)	$ 7,427.8	$ 7,299.9
3. Total Accounts Receivable:	$ 9,146.6	$ (600.5)	$ 8,546.1	$ 8,366.5

Note 6. Other Assets

As of September 30	2004	2003
(Amounts in millions)		
1. Intragovernmental Other Assets:		
A. Advances and Prepayments	$ 1,011.9	$ 105.0
B. Total Intragovernmental Other Assets	$ 1,011.9	$ 105.0
2. Non-Federal Other Assets:		
A. Outstanding Contract Financing Payments	$ 18,451.6	$ 18,868.7
B. Other Assets (With the Public)	3,034.7	2,860.9
C. Total Non-Federal Other Assets	$ 21,486.3	$ 21,729.6
3. Total Other Assets:	$ 22,498.2	$ 21,834.6

Fluctuations

Total Intragovernmental Advances and Prepayments increased $906.9 million (864 percent). Improved business processes allowed the Department in FY 2004 to capture advances to others with other federal agencies.

Note 7. Cash and Other Monetary Assets

As of September 30		2004		2003
(Amounts in millions)				
1. Cash	$	1,811.1	$	1,290.8
2. Foreign Currency (non-purchased)		367.0		244.1
3. Total Cash, Foreign Currency, & Other Monetary Assets	$	2,178.1	$	1,534.9

Fluctuations

Total Cash, Foreign Currency and Other Monetary Assets increased $643.2 million (42 percent) primarily resulting from increases in cash on hand to support Operation Iraqi Freedom and Operation Enduring Freedom. Cash increased by $520.3 million (40 percent). This increase was primarily due to increases of $388.1 million for the Army General Fund and $166.9 million for the Air Force General Fund.

Overall foreign currency increased by $122.9 million (50 percent). This fluctuation was primarily the result of an increase of $182.6 million for the Army General Fund due to additional requirements for foreign currency to support Army military operations. This increase was offset by a decrease of $56.2 million for the Navy General Fund as a result of the Navy drawdown related to Operation Iraqi Freedom. In addition, the U.S. Army Corps of Engineers received additional foreign currency from the Republic of Korea for reimbursable work to be performed. The foreign currency is primarily required to (1) pay foreign vendors, (2) provide cash for agents in support of deployed tactical units, and (3) provide currency for exchange of U.S. dollars for troops stationed overseas to support Operation Iraqi Freedom and Operation Enduring Freedom.

Other Information

The majority of cash and all foreign currency is classified as nonentity and its use is, therefore, restricted. Approximately $1.7 billion in cash and $367 million in foreign currency are restricted.

Note 8. Direct Loan and/or Loan Guarantee Programs

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

Military Housing Privatization Initiative
Armament Retooling & Manufacturing Support Initiative

The "Federal Credit Reform Act of 1990" (CRA) governs all amended direct loan obligations and loan guarantee commitments made after FY 1991 resulting in direct loans or loan guarantees. Direct loans are reported at the net present value of the following cash flows:

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

Loan guarantee liabilities are reported at the net present value of the following cash flows:

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

Military Housing Privatization Initiative

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

Armament Retooling and Manufacturing Support Initiative

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

The US Department of Agriculture Rural Business-Cooperative Service (RBS) and the Department of the Army established a Memorandum of Understanding (MOU) to furnish services to the Army in connection with the ARMS Initiative Loan Guarantee Program (AILG) pursuant to Section 193 of the Armament Retooling and Manufacturing Support Act of 1992 (P.L. 102-484), as amended (10 USC 2501 note). The National Defense Authorization Act for Fiscal Year 1995 (P.L. 103-337) authorized the Army to enter into this MOU with RBS pursuant to 31 USC 1535. The RBS has the necessary programmatic and administrative services and provides other services required to administer the AILG Program. Therefore, to ensure service to the public and for protection of the federal interests and rights, it was necessary for the Army to obtain service from the RBS.

Direct Loans Obligated After FY 1991

As of September 30	2004	2003
(Amounts in millions)		
Military Housing Privatization Initiative:		
A. Loans Receivable Gross	$ 141.5	$ 129.1
B. Allowance for Subsidy Cost (Present Value)	(70.8)	(65.1)
C. Value of Assets Related to Direct Loans	$ 70.7	$ 64.0
Total Loans Receivable:	$ 70.7	$ 64.0

Subsidy costs are recognized when direct loans are disbursed to borrowers and are re-estimated each year as of the date of the financial statements. The allowance for subsidy cost is the difference between the outstanding principal of the loans and the present value of their net cash flows. New loans in the amount of $12.4 million were disbursed relating to housing at Camp Pendleton, California. The increase in the allowance for subsidy for new loans was proportionate to the increase in new loans receivable. The allowance was also adjusted for subsidy re-estimates and subsidy amortization totaling $2.6 million. Subsidy amortization is the net of interest revenue and interest expense. FY 2004 subsidy amortization represents the difference between net borrowing from the Treasury and loans receivable.

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

		(in millions)
Dyess Air Force Base, Texas	$	28.9
Elmendorf Air Force Base, Alaska		48.0
Lackland Air Force Base, Texas		10.6
Warner-Robins Air Force Base, Georgia		22.3
Camp Pendleton Marine Corps Base, California		29.4
Kingsville Air Force Base, Texas		2.5
Total		**141.7**
Less: Previous Principal Repayments		(0.2)
Loans Receivable Gross	**$**	**141.5**

Total Amount of Direct Loans Disbursed

As of September 30	2004	2003
(Amounts in millions)		
Direct Loan Program		
Military Housing Privatization Initiative:	$ 12.4	$ 36.7
Total	$ 12.4	$ 36.7

New direct loans disbursed had a decrease of $24.3 million (66 percent). This change is due to the reduced number of direct loans issued. The demand for direct loans by private developers varies from year to year depending upon the progression of planned construction and renovation and upon economic factors unrelated to the operations of the Department of Defense.

Total direct loans disbursed in FY 2004 for the MHPI program are:

		(in millions)
Camp Pendleton Marine Corps Base, California	$	12.4
Total Direct Loans Disbursed	$	12.4

Subsidy Expense for Post-1991 Direct Loans

As of September 30 (Amounts in millions)					
2004	Interest Differential	Defaults	Fees	Other	Total
1. Subsidy Expense for New Direct Loans Disbursed:					
MilitaryHousing Privatization Initiative	$ 7.7	$ 0.5	$ 0.0	$ 0.0	$ 8.2
Total	$ 7.7	$ 0.5	$ 0.0	$ 0.0	$ 8.2
2003	Interest Differential	Defaults	Fees	Other	Total
2. Subsidy Expense for New Direct Loans Disbursed:					
Military Housing Privatization Initiative	$ 19.2	$ 4.1	$ 0.0	$ 0.0	$ 23.3
Total	$ 19.2	$ 4.1	$ 0.0	$ 0.0	$ 23.3
2004	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Re-estimates	Total
3. Direct Loan Modifications and Reestimates:					
Military Housing Privatization Initiative	$ (0.7)	$ (2.0)	$ 0.1	$ (1.9)	$ (2.6)
Total	$ (0.7)	$ (2.0)	$ 0.1	$ (1.9)	$ (2.6)

	2004	2003
4Total Direct Loan Subsidy Expense:		
Military Housing Privatization Initiative	$ 5.6	$ 23.3
Total	$ 5.6	$ 23.3

The interest rate and default cost values represent the amounts for the loans disbursed in FY 2004. These rates are established for each individual loan. The interest rate re-estimate for subsidy cost is an adjustment to subsidy cost from the assumed interest rates used in the budget preparations to the interest rates that are applicable to the periods in which the loans are disbursed. Technical/default re-estimate is an adjustment to subsidy cost based on the latest projections of defaults, delinquencies, recoveries, prepayments or other cash flow components.

The decline in the reporting of Interest Rate Differential Costs and Default Costs is proportional to the number of loans disbursed. The $17.7 million decrease in the direct loan subsidy expense primarily resulted from the reduction in loans disbursed. Additionally, subsidy expense was impacted by a downward re-estimate of subsidy for loans disbursed in prior fiscal years and subsidy allowance amortization. The subsidy rate differs for each project, from 66 percent for Camp Pendleton Marine Corps Base, California to 43 percent for Elmendorf Air Force Base, Alaska. This difference has a direct impact on the variance from FY 2003 to FY 2004.

Subsidy Rate for Direct Loans

	Interest Differential	Defaults	Fees	Other	Total
Military Housing Privatization Initiative	24.26%	9.96%	0.00%	0.00%	34.22%

Subsidy rates pertain to the loan agreements contracted during the current fiscal year. These rates cannot be applied to the direct loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loans disbursed in the current year could result from disbursement of loans from both current and prior-year loan agreements.

Subsidy rates for FY 2004 are included in the FY 2005 Presidential Budget Federal Credit Supplement and are published at the following website:

http://www.whitehouse.gov/omb/budget/fy2005/pdf/cr_supp.pdf

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

Beginning Balance, Changes and Ending Balance	2004		2003	
(Amounts in millions)				
1. Beginning Balance of the Subsidy Cost Allowance	$	65.1	$	41.8
2. Add: Subsidy Expense for Direct Loans Disbursed during the Reporting Years by Component				
A. Interest Rate Differential Costs	$	7.7	$	19.2
B. Default Costs (Net of Recoveries)		0.5		4.1
C. Total of the above Subsidy Expense Components	$	8.2	$	23.3
3. Adjustments				
A. Subsidy Allowance Amortization		(0.6)		0.0
B. Total of the above Adjustment Components	$	(0.6)	$	0.0
4. Ending Balance of the Subsidy Cost Allowance before Re-estimates	$	72.7	$	65.1
5. Add or Subtract Subsidy Re-estimates by Component				
A. Interest Rate Re-estimate	$	(2.0)	$	0.0
B. Technical/default Re-estimate	$	0.1		0.0
C. Total of the above Re-estimate Components	$	(1.9)	$	0.0
6. Ending Balance of the Subsidy Cost Allowance	$	70.8	$	65.1

Defaulted Guaranteed Loans from Post-1991 Guarantees

As of September 30, 2004, the Department had no defaulted guaranteed loans.

Guaranteed Loans Outstanding

As of September 30	Outstanding Principal, Guaranteed Loans, Face Value	Amount of Outstanding Principal Guaranteed
Guaranteed Loans Outstanding:		
1. Military Housing Privatization Initiative	$ 389.0	$ 389.0
2. Armament Retooling & Manufacturing Support Initiative	$ 27.1	$ 24.3
3. Total	$ 416.1	$ 413.3

Guaranteed Loans Outstanding for the MHPI program as of the end of September 30, 2004 consist of the following:

		(in millions)
Warner-Robins Air Force Base, Georgia	$	25.6
Fort Carson Army Installation, Colorado		147.0
Kirtland Air Force Base, New Mexico		74.0
Wright Patterson Air Force Base, Ohio		65.0
Elmendorf Air Force Base, Alaska		48.0
Lackland Air Force Base, Texas		29.4
Total	**$**	**389.0**

Liability for Post-1991 Loan Guarantees, Present Value

As of September 30 (Amounts in millions)	2004	2003
Loan Guarantee Program Title		
1. Military Housing Privatization Initiative	$ 22.1	$ 24.6
2. Armament Retooling & Manufacturing Support Initiative	12.3	1.3
3. Total	$ 34.4	$ 25.9

MHPI

The $2.5 million (10 percent) decrease is attributable to a technical reestimate of the subsidy. For additional information, see Note 8.L, Schedule for Reconciling Loan Guarantee Liability Balances for Post-1991 Loan Guarantees. There were no new guaranteed loans created in FY 2004.

ARMS

Total loan guarantee liabilities increased $11.0 million (846 percent) primarily due to the new FY 2004 loan obligation and a liability for an impending loss claim. There were no new guaranteed loans created in FY 2004.

Subsidy Expense for Post-1991 Loan Guarantees

As of September 30					
(Amounts in millions)					
2004	Interest Differential	Defaults	Fees	Other	Total
1. Subsidy Expense for New Loan Guarantees Disbursed:					
Armament Retooling and Manufacturing Support Initiative	$ 0.0	0.2	(0.1)	0.0	0.1
Total	$ 0.0	$ 0.2	$ (0.1)	$ 0.0	$ 0.1
2003	Interest Differential	Defaults	Fees	Other	Total
2. Subsidy Expense for New Loan Guarantees Disbursed:					
Military Housing Privatization Initiative	$ 0.0	$ 11.3	$ 0.0	$ 0.0	$ 11.3
Armament Retooling and Manufacturing Support Initiative	$ 0.0	0.1	(0.0)	0.0	0.1
Total	$ 0.0	$ 11.4	$ 0.0	$ 0.0	$ 11.4
2004	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
3. Loan Guarantee Modifications and Reestimates:					
Military Housing Privatization Initiative	$ 1.9	$ 0.0	$ (4.4)	$ 0.0	$ (2.5)
Armament Retooling and Manufacturing Support Initiative	0.0	0.0	7.5	0.0	7.5
Total	$ 1.9	$ 0.0	$ 3.1	$ 0.0	$ 5.0

4. Total Loan Guarantee Subsidy Expense	2004	2003
Military Housing Privatization Initiative	$ (2.5)	$ 11.3
Armament Retooling and Manufacturing Support Initiative	7.6	0.1
Total	$ 5.1	$ 11.4

MHPI

The MHPI created no new loan guarantees during FY 2004; however, MHPI had a $2.5 million downward re-estimate, resulting in the negative subsidy expense.

ARMS

ARMS created no new loan guarantees during FY 2004. The change in ARMS subsidy expense is due primarily to an upward subsidy re-estimate. For additional information, see Note 8.L, Schedule for Reconciling Loan Guarantee Liability Balances for Post-1991 Loan Guarantees.

Subsidy Rate for Loan Guarantees

	Interest Supplements	Defaults	Fees and other Collections	Other	Total
Loan Guarantees:					
1. Military Housing Privatization Initiative:	0.00%	9.65%	0.00%	0.00 %	9.65%
2. Armament Retooling & Manufacturing Support Initiative	0.00%	4.97%	-1.60%	0.00 %	3.37%

MHPI

The subsidy rates disclosed pertain only to loan agreements made during the current fiscal year. These rates cannot be applied to the direct loans disbursed during the current fiscal year to yield the subsidy expense. The subsidy expense for new loans reported in the current year result from disbursements of loans from both current year loan agreements and prior year(s) loan agreements. The subsidy expense reported in the current year also includes modifications and reestimates.

These FY 2004 loan guarantee subsidy rates are published in the FY 2005 Federal Credit Supplement at the following web site:

http://www.whitehouse.gov/omb/budget/fy2005/pdf/cr_supp.pdf

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

Beginning Balance, Changes and Ending Balance	2004	2003
(Amounts in millions)		
1. Beginning Balance of the Loan Guarantee Liability	$ 25.9	$ 14.1
2. Add: Subsidy Expense for Guaranteed Loans Disbursed during the Reporting Years by Component		
A. Default Costs (Net of Recoveries)	0.2	11.4
B. Fees and Other Collections	(0.1)	0.0
C. Total of the above Subsidy Expense Components	$ 0.1	$ 11.4
3. Adjustments		
A. Fees Received	$ 0.0	$ 0.4
B. Interest Accumulation on the Liability Balance	5.3	0.0
C. Total of the above Adjustments	$ 5.3	$ 0.4
4. Ending Balance of the Loan Guarantee Liability before Re-estimates	$ 31.3	$ 25.9
5. Add or Subtract Subsidy Re-estimates by Component		
A. Technical/default Re-estimate	$ 3.1	$ 0.0
B. Total of the above Re-estimate Components	$ 3.1	$ 0.0
6. Ending Balance of the Loan Guarantee Liability	$ 34.4	$ 25.9

Loan guarantee liabilities are re-estimated each year as of the date of the financial statements. As of result of the re-estimations for FY 2004, MHPI had a downward subsidy re-estimate of $4.4 million and ARMS had an upward subsidy re-estimate of $7.5 million. Funding for the upward loan subsidy re-estimate is expected in the next fiscal year. The downward re-estimate will be returned to the Treasury.

Administrative Expense

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

Administrative Expense for the ARMS is a fee paid to theU.S.Department of Agriculture RBS for administering the loan guarantees under the ARMS, which is a joint program. Administrative Expense for the ARMS is immaterial to the DoD financial statements.

Note 9.	Inventory and Related Property

As of September 30	2004	2003
(Amounts in millions)		
1. Inventory, Net	$ 68,207.9	$ 64,365.4
2. Operating Materials & Supplies, Net	143,489.7	139,351.2
3. Stockpile Materials, Net	1,521.8	1,828.0
4. Total	$ 213,219.4	$ 205,544.6

Inventory, Net

As of September 30	2004 Inventory, Gross Value	2004 Revaluation Allowance	2004 Inventory, Net	2003 Inventory, Net	Valuation Method
(Amounts in millions)					
1. Inventory					
A. Available and Purchased for Resale	$ 75,931.7	$ (33,557.2)	42,374.5	$ 42,216.0	LAC, MAC
B. Held for Repair	30,027.6	(5,369.7)	24,657.9	20,206.3	LAC, MAC
C. Excess, Obsolete, and Unserviceable	5,368.1	(5,368.1)	0.0	0.0	NRV
D. Raw Materials	21.3	0.0	21.3	9.8	MAC,SP,LAC
E. Work in Process	1,154.2	0.0	1,154.2	1,933.3	AC
F. Total	$ 112,502.9	$ (44,295.0)	68,207.9	$ 64,365.4	

Legend for Valuation Methods:

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

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

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

General Composition of Inventory

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

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

Restatement of Prior Year Balance

Inventory, Net and Total Inventory and Related Property include a prior-year adjustment and restatement of $11.4 billion for fiscal year 2003. The restatement of the 2003 comparative balances is due to Inventory valuation changes and errors recorded by the Air Force. Refer to Note 20 – Statement of Changes in Net Position for additional information.

Operating Materials and Supplies, Net

As of September 30	2004			2003	
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	Valuation Method
(Amounts in millions)					
1. OM&S Categories:					
A. Held for Use	$ 127,765.1	$ 0.0	$ 127,765.1	$ 122,732.3	SP, LAC
B. Held for Repair	18,035.4	(2,310.8)	15,724.6	16,618.9	SP, LAC
C. Excess, Obsolete, and Unserviceable	3,128.9	(3,128.9)	0.0	0.0	NRV
D. Total	$ 148,929.4	$ (5,439.7)	$ 143,489.7	$ 139,351.2	

Legend for Valuation Methods:

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

NRV = Net Realizable Value

SP = Standard Price

Generally, there are no restrictions on the use or disposition of operating materials and supplies.

General Composition of Operating Materials and Supplies

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

Fluctuations

OM&S increased by $4.1 billion (3 percent). The primary factors are as follows:

The Army General Fund reported its OM&S increased by $5.1 billion. The net increase is attributable to an increase in Missile Procurement, Army OM&S reported by the U. S. Army Aviation and Missile Command and an increase being reported in the Worldwide Ammunition Reporting System (WARS). The Missile Procurement's increase is the result of movement of funding from Procurement, Defense-wide to Missile Procurement, Army for the Patriot Advance Capability 3 in support of the global war on terror. The WARS increase is the result of Operation Iraqi Freedom, movement to uses other than basic load and training, retrograde and asset movement from troops to ammunition storage points, and Central Command inventory reconciliation.

The Air Force General Fund reported a decrease of $1.1 billion because of a change in methodology for valuing its OM&S. In FY 2003, uninstalled motors were valued at Latest Acquisition Cost while in FY 2004, they were valued at Moving Average Cost. Many of the old uninstalled missile motors reported in FY 2003 as excess have been refurbished and are now being reported as "held for use," and some motors have been destroyed.

Stockpile Materials, Net

As of September 30	2004 Stockpile Materials Amount	2004 Allowance for Gains (Losses)	2004 Stockpile Materials, Net	2003 Stockpile Materials, Net	Valuation Method
(Amounts in millions)					
1. Stockpile Materials Categories:					
A. Held for Sale	$ 1,427.7	$ 0.0	$ 1,427.7	$ 1,691.8	AC,LCM
B. Held in Reserve for Future Sale	94.1	0.0	94.1	136.2	AC,LCM
C. Total	$ 1,521.8	$ 0.0	$ 1,521.8	$ 1,828.0	

Legend for Valuation Methods:

AC = Actual Cost LCM = Lower of Cost or Market

Fluctuations

Stockpile, Net decreased $306.2 million (16.7 percent). The National Stockpile Fund reported the decrease of $42.1 million in its inventory held in reserve for future use is due to a systemic programming error in 2003 which was subsequently corrected. The decrease of $264.1 million in inventory held for sale is the result of material sales in FY 2004. Since the National Stockpile mission does not call for replenishing inventories, there will always be an annual decline of inventory.

General Composition of Stockpile Materials

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

Note 10.	General PP&E, Net

As of September 30	2004					2003
	Depreciation / Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
(Amounts in millions)						
1. Major Asset Classes:						
A. Land	N/A	N/A	$ 10,103.0	N/A	$ 10,103.0	$ 9,663.4
B. Buildings, Structures, and Facilities	S/L	20 Or 40	159,446.9	$ (91,463.2)	67,983.7	76,388.0
C. Leasehold Improvements	S/L	lease term	139.1	(96.3)	42.8	96.2
D. Software	S/L	2-5 Or 10	6,051.9	(3,555.9)	2,496.0	2,392.7
E. General Equipment	S/L	5 or 10	45,285.8	(29,314.0)	15,971.8	338,054.2
F. Military Equipment	S/L	Various	1,147,340.0	(822,900.0)	324,440.0	0.0
G. Assets Under Capital Lease[1]	S/L	lease term	585.9	(379.2)	206.7	233.6
H. Construction-in- Progress	N/A	N/A	19,574.6	N/A	19,574.6	19,388.3
I. Other			83.1	(3.1)	80.0	92.5
J. Total General PP&E			$ 1,388,610.3	$ (947,711.7)	$ 440,898.6	$ 446,308.9

[1] See Note 15 on Capital Lease Liability for additional information

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

Fluctuations

General Property, Plant and Equipment (PP&E) decreased $5.4 billion (1 percent). The significant changes are summarized below:

Buildings, Structures and Facilities decreased 8.4 billion (11 percent). The majority of this decrease was the result of an error in Navy General Fund data captured for FY 2003 accumulated depreciation. This error was corrected in FY 2004.

Leasehold Improvements reflected a net decrease of $53.4 million (56 percent). The decrease is primarily attributable to the DFAS Working Capital Fund's one-time reclassification of $48.3 million from Buildings, Structures and Facilities to Leasehold Improvements in FY 2003.

In FY 2004, the Department elected to display Military Equipment and General Equipment on separate lines for reporting purposes. The breakdown of the FY 2003 balance is a net book value of $13 billion for General Equipment and $325.1 billion for Military Equipment, therefore the true increase in General Equipment is $3 billion. This increase is the result of the procurement of new equipment and better recognition of existing equipment.

Assets Under Capital Lease

As of September 30	2004	2003
(Amounts in millions)		
1. Entity as Lessee, Assets Under Capital Lease:		
A. Land and Buildings	$ 574.6	$ 574.6
B. Equipment	11.3	2.6
C. Accumulated Amortization	(379.2)	(343.6)
D. Total Capital Leases	$ 206.7	$ 233.6

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

Fluctuations

Assets Under Capital Lease decreased $26.9 million (12 percent). This change is due to normal depreciation expense in FY 2004.

Other Disclosures

Imputed interest was necessary to reduce net minimum lease payments to the present value calculated at the incremental borrowing rate at the inception of the leases.

Note 11.	Liabilities Not Covered by Budgetary Resources

As of September 30		2004		2003
(Amounts in millions)				
1. Intragovernmental Liabilities				
A. Accounts Payable	$	9.2	$	0.0
B. Debt		15.0		18.2
C. Other		5,303.1		4,814.5
D. **Total Intragovernmental Liabilities**	$	5,327.3	$	4,832.7
2. Non-Federal Liabilities				
A. Accounts Payable	$	695.8	$	0.0
B. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities		1,348,776.0		1,233,557.2
C. Environmental Liabilities		60,979.4		58,047.6
D. Other Liabilities		15,158.0		12,552.1
E. **Total Non-Federal Liabilities**	$	1,425,609.2	$	1,304,156.9
3. Total Liabilities Not Covered by Budgetary Resources	$	1,430,936.5	$	1,308,989.6
4. Total Liabilities Covered by Budgetary Resources	$	279,177.1	$	250,648.9
5. Total Liabilities	$	1,710,113.6	$	1,559,638.5

Liabilities Not Covered by Budgetary Resources are those liabilities which are not considered covered by realized budgetary resources as of the Balance Sheet date. For additional disclosures see Note 17 for Military Retirement Benefits and Other Employment Related Actuarial Liabilities, and Note 14 for Environmental Liabilities.

Fluctuations

Intragovernmental Accounts Payable

Intragovernmental Accounts Payable increased $9.2 million. In accordance with Treasury guidance Accounts Payable from Cancelled Appropriations moved from Intragovernmental Other Liabilities to Accounts Payable. This change became effective in FY 2004.

Intragovernmental Debt

Debt decreased $3.2 million (17.6 percent) as a result of debt reduction payments by the U.S. Army Corps of Engineers and U.S. Transportation Command of $2.0 million and $1.2 million, respectively.

Intragovernmental – Other

Intragovernmental Liabilities-Other (not covered by budgetary resources) increased $488.6 million (10 percent) and consist primarily of contractor debt and associated accrued interest receivable, workmen's compensation, judgment fund liabilities, and other custodial liabilities.

Other liabilities reported by the U.S. Army Corps of Engineers increased because Uncollected Custodial Liability totaling $65.2 million is reported with Liabilities Not Covered by Budgetary Resources. The liability was previously reported with Liabilities Covered by Budgetary Resources.

Federal Employees Compensation Act and Unemployment Compensation liabilities increased $153 million and $69 million respectively, due to the increase in personnel supporting the war in Iraq. The Navy GF increase of $53.0 million resulted from interest recorded and due to the Treasury from pending litigation on the A-12 program. Additionally, Navy GF liabilities increased $66 million because of improved processes for recording receipt of funds from cancelled appropriations that are due to the Treasury.

Non-Federal Accounts Payable

Non-Federal Accounts Payable increased $695.8 million. In accordance with Treasury guidance, Accounts Payable from Cancelled Appropriations were moved from Non-Federal Other Liabilities to Accounts Payable.

Military Retirement Benefits and Other Employment-Related Actuarial Liabilities

Military Retirement Benefits and Other Employment Related Actuarial Liabilities increased by $115.2 billion (9 percent). This is related to an increase in the actuarial liability of $140.1 billion that is offset by an increase of $24.9 billion in the value of assets available to pay benefits.

Non-Federal Other

Non-Federal Other Liabilities (not covered by budgetary resources) increased $2.6 billion (21 percent).

The Defense Health Program (DHP) reports an increase in the amount of $1.3 billion. The increase is attributable to the Incurred But Not Reported (IBNR) Liability. This liability is an estimated liability for medical claims incurred by the Defense Health Plan, but not yet reported. The DoD Office of the Actuary developed this estimate based on historical data showing medical claims by incurred date and paid date. This estimate also included factors such as administrative costs associated with the incurred but not reported claims, medical inflation, and the rate of beneficiary utilization of Defense medical services. The population base of this estimate is non-Medicare-eligible beneficiaries of the DHP. This includes non-Medicare-eligible active duty military personnel and family members, as well as non-Medicare-eligible military retirees, dependents and survivors. The remaining change relates to multiple entities that individually do not comprise 10 percent of the total change.

The Defense Security Cooperation Agency Foreign Military Sales (FMS) Trust Fund reported an increase of $1.2 billion in custodial liability. This increase is related to the change in the net custodial cash balance. The liability represents net advances received from the foreign customers less the funds expensed on their behalf. When the cash balance increases, a corresponding liability is created. However, the FMS customer retains ownership of the cash. Until the funds are expended, a liability is created to anticipate the possible refund of the money to the customers. Fluctuations of this nature are due to normal business practices and are not uncommon for the FMS program. The remaining change relates to multiple entities that individually do not comprise 10 percent of the total change.

Other Information Related to Liabilities Not Covered By Budgetary Resources

Non-Federal Other Liabilities (not covered by budgetary resources) consist primarily of the following:

	(in millions)
Unfunded Annual Leave	$ 7,991.5
Non-environmental Disposal Liabilities	2,443.7
Contingent Liabilities	1,456.3
Other Unfunded Employment-Related Liabilities	1,793.6
Custodial Liability	1,352.2
Other	130.7
Total	**$15,158.0**

Total Liabilities Covered by Budgetary Resources

Prior period had been adjusted upward for $1 billion (reference to Note 20). In December 1994, the Office of the Under Secretary of Defense (Comptroller), OUSD(C), decentralized cash management responsibilities. In this decentralization, the Navy Working Capital Fund received over $1.0 billion in undistributed disbursements. DoD reclassified this amount from Other Liabilities to Cumulative Results. Specifically, the adjustment takes into consideration the guidance provided by SFAS 16, APB 20, and SFFAS No.21, all of which address the treatment of errors and disclosure of prior period adjustments.

Note 12. Accounts Payable

As of September 30	2004			2003
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
(Amounts in millions)				
1. Intragovernmental Payables:	$ 1,888.4	N/A	$ 1,888.4	$ 101.4
2. Non-Federal Payables (to the Public):	$ 28,307.2	$ 1.8	$ 28,309.0	$ 27,863.8
3. Total	$ 30,195.6	$ 1.8	$ 30,197.4	$ 27,965.2

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

Fluctuations

Intragovernmental Accounts Payable

Intragovernmental accounts payable increased $1.8 billion, (1,762 percent).

Improved business processes and implementation of estimating methodologies allowed DoD agencies to record accounts payable with agencies outside DoD. These new processes resulted in an increase of intragovernmental accounts payable for the following entities:

Army General Fund	$738.7 million
Navy General Fund	$396.6 million
Navy Working Capital Fund	$43.7 million
Air Force General Fund	$542.4 million

Note 13. Debt

As of September 30	2004			2003
(Amounts in millions)	Beginning Balance	Net Borrowings	Ending Balance	Ending Balance
1. Public Debt:				
A. Held by Government Accounts	N/A	N/A	N/A	N/A
B. Held by the Public	N/A	N/A	N/A	N/A
C. Total Public Debt	N/A	N/A	N/A	N/A
2. Agency Debt:				
A. Debt to the Treasury	$ 81.3	$ 4.2	$ 85.5	$ 81.3
B. Debt to the Federal Financing Bank	616.9	(110.6)	506.3	616.9
C. Total Agency Debt	$ 698.2	$ (106.4)	$ 591.8	$ 698.2
3. Total Debt:	$ 698.2	$ (106.4)	$ 591.8	$ 698.2
4. Classification of Debt:				
A. Intragovernmental Debt			$ 591.8	$ 698.2
B. Non-Federal Debt			N/A	N/A
C. Total Debt			$ 591.8	$ 698.2

Fluctuations

Debt to the Treasury

The outstanding debt consists of interest and principal payments due to the Treasury. The $4.2 million (5 percent) increase in Debt to the Treasury consists of a $6.2 million increase to a loan subsidy program related to the Family Housing Improvement Fund's Military Housing Privatization Initiative (MHPI), offset by a $2.0 million decrease to the U.S. Army Corps of Engineers promissory notes with the Treasury Fund Capital Improvements to the Washington Aqueduct.

The MHPI combines funds borrowed from the Treasury with appropriated funds (direct loan subsidy appropriation) to provide direct loans to private developers to build or renovate military family housing. A $6.2 million (10 percent) increase in Debt to the Treasury is primarily due to borrowing money from the Treasury to cover direct loans related to military family housing at Camp Pendleton Marine Corps Base and six Air Force bases. See Note 8 for additional information regarding direct loans for the MHPI.

During FY's 1997, 1998, and 1999, the U.S. Army Corps of Engineers executed three promissory notes totaling $75.0 million with the Department of the Treasury. The funds provided by these notes were used for capital improvements to the Washington Aqueduct. Arlington County; Falls Church, Virginia; and the District of Columbia provide funding to repay the debt. There was a net decrease in debt of $2.0 million (12 percent) resulting in a balance due to the Treasury of $15.4 million.

Debt to the Federal Financing Bank

Debt owed to the Federal Financing Bank (FFB) decreased by $110.6 million (18 percent). This decrease is primarily due to the payments made to reduce the outstanding debt principal amount for the Department of the Navy Transportation Activity Group ($109.3 million) and the U.S. Transportation Command ($1.3 million).

As part of the Afloat Prepositioning Force program, the Department of the Navy makes loan repayments to the FFB on behalf of ship owners in lieu of capital lease payments to the ship owners. The FFB is reporting a debt in the amount of $506.3 million for the Transportation Activity, which represents an outstanding principal balance of $498.6 million and accrued interest payable of $7.7 million.

The debt on the part of U.S. Transportation Command consists of the principal and accrued interest balances left on the Military Sealift Command's (MSC) T-5 program that provides ships for time charter to the MSC to meet requirements not available in the marketplace. The ships were financed with approximately 30 percent equity investments and 70 percent debt borrowings. The debt is in the form of loans from the FFB to the vessel owners. In order to simplify the payments, the FFB transfers funds from the Navy Working Capital fund to itself and applies these funds to the vessel owners' loans. This is done semi-annually. The MSC records the equity payments upon receipt of invoices. The balance due to the FFB ($1.3 million) was paid in full in July 2004. The MSC purchased all but the Darnell class T-5 ships.

Note 14.	Environmental Liabilities and Disposal Liabilities

As of September 30	2004			2003
	Current Liability	Noncurrent Liability	Total	Total
(Amounts in millions)				
1. Environmental Liabilities – Non Federal				
A. Accrued Environmental Restoration (DERP funded) Costs:				
1. Active Installations--Environmental Restoration (ER)	$1,752.0	$9,116.2	$10,868.2	$11,833.8
2. Active Installations--ER for Closed Ranges	63.3	7,645.7	7,709.0	4,362.1
3. Formerly Used Defense Sites (FUDS) -- ER	341.0	3,980.3	4,321.3	4,239.4
4. FUDS--ER for Transferred Ranges	149.3	13,935.0	14,084.3	13,624.4
B. Other Accrued Environmental Costs (Non-DERP funds)				
1. Active Installations--Environmental Corrective Action	52.3	517.3	569.6	561.0
2. Active Installations--Environmental Closure Requirements	16.0	162.5	178.5	103.6
3. Active Installations--Environ. Response at Active Ranges	62.5	217.1	279.6	276.3
4. Other	0.4	8.8	9.2	50.0
C. Base Realignment and Closure (BRAC)				
1. BRAC Installations--Environmental Restoration (ER)	670.6	2,450.3	3,120.9	3,616.6
2. BRAC Installations--ER for Transferring Ranges	11.3	524.6	535.9	511.6
3. BRAC Installations--Environmental Corrective Action	15.3	152.5	167.8	187.9
4. Other	209.3	0.0	209.3	190.4

D. Environmental Disposal for Weapons Systems Programs				
1. Nuclear Powered Aircraft Carriers	0.0	5,693.0	5,693.0	5,565.0
2. Nuclear Powered Submarines	42.4	5,146.3	5,188.7	4,888.9
3. Other Nuclear Powered Ships	86.5	201.0	287.5	269.1
4. Other National Defense Weapons Systems	5.8	266.1	271.9	297.1
5. Chemical Weapons Disposal Program	1,096.9	9,672.6	10,769.5	10,810.3
6. Other	103.0	0.0	103.0	103.1
2. Total Environmental Liabilities:	$ 4,677.9	$ 59,689.3	$ 64,367.2	$ 61,490.6

Service Component – Environmental Restoration (Clean up) Liabilities and Environmental Disposal Liabilities (Amounts in millions)	Army	Navy	Air Force	ODO
1. Environmental Liabilities:				
A. Non-Federal:				
1. Accrued Environmental Restoration (Defense Environmental Restoration Program (DERP) funded) Costs:				
a. Active Installations-Environmental Restoration (ER)	$ 3,520.4	$ 2,841.5	$ 4,225.2	$ 281.1
b. Active Installations--ER for Closed Ranges	5,781.1	583.0	1,344.9	
c. Formerly Used Defense Sites (FUDS) –ER	4,321.3			
d. FUDS--ER for Transferred Ranges	14,084.3			
2. Other Accrued Environmental Costs (Non-DERP funds)				
a. Active Installations--Environmental Corrective Action	259.0		182.4	128.2
b. Active Installations--Environmental Closure Requirements	51.2		112.3	15.0
c. Active Installations--Environ. Response at Active Ranges	267.6			12.0
d. Other				9.2
3. Base Realignment and Closure (BRAC)				
a. BRAC Installations--Environmental Restoration (ER)	597.4	1,110.7	1,379.7	33.1
b. BRAC Installations--ER for Transferring Ranges	480.1	55.8		
c. BRAC Installations--Environmental Corrective Action	25.0		142.8	
d. Other	209.3			
4. Environmental Disposal for Weapon Systems Programs				
a. Nuclear Powered Aircraft Carriers		5,693.0		
b. Nuclear Powered Submarines		5,188.7		
c. Other Nuclear Powered Ships		287.5		
d. Other National Defense Weapon Systems		271.9		

		271.9		
e. Chemical Weapons Disposal Program	10,769.5			
f. Other				103.0
5. Total Non-Federal Environmental Liabilities:	$ 40,366.2	$16,032.1	$ 7,387.3	$ 581.6

Others Category Disclosure Comparative Table

Types	September 30, 2004 (in millions)
Other Accrued Environmental Costs (Non-DERP funds)	
Defense Commissary Agency	**$ 9.2**
Base Realignment and Closure	
Army's prior BRAC unliquidated obligations that cannot be identified to a specific program	**$ 209.3**
Environmental Disposal for Weapons Systems Programs-Other	
DoD Component Level Accounts National Defense Stockpile - ODO	**$ 103.0**

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

The Department is currently using two independently validated estimating models in addition to engineering estimates. Validation of the models was performed in accordance with DoD Instruction 5000.61. The models are the Remedial Action Cost Engineering Requirements (RACER) model and the Department of Navy Cost-to-Complete (CTC) module of the Navy Normalization of Data System (NORM). Additionally, cost estimates are based on the following: (1) historic comparable project, (2) a specific bid or independent government cost estimate for the project, (3) site level data, and (4) annual cost-to-complete estimate. The cost-to-complete estimate is prepared in the Defense Environmental Restoration Program (DERP).

The DoD has clean up requirements for the DERP sites at active and BRAC installations and formerly used defense sites (FUDS), non-DERP at active installations, weapon systems programs, and chemical weapons disposal programs. The DoD follows the Comprehensive Environmental Response, Compensation Liability Act (CERCLA) and the Superfund Amendment and Reauthorization Act (SARA) to clean up DERP-eligible contamination. Non-DERP eligible contamination cleanup is performed in accordance with the Resource Conservation and Recovery Act (RCRA). The Army is the DoD Executive Agent for cleaning up contamination at sites formerly used by DoD. The CERCLA and RCRA require DoD to clean up contamination in coordination with regulatory agencies, other responsible parties, and current property owners. Failure to comply with agreements and legal mandates can put DoD at risk of fines and penalties.

The Chemical Weapons Disposal Program is based on the FY 1986 National Defense Authorization Act (PL 99-145, as amended by subsequent acts) that directed the DoD to destroy the unitary chemical stockpile by April 29, 2004. The current guidelines for destruction are based on the Chemical Weapons Convention (CWC) treaty. The United

States ratified the treaty in April 1997 and, according to the terms outlined, the United States must destroy its declared stockpile of chemical weapons by April 2007. The Army, as Executive Agent within the DoD, provides policy, direction, and oversight for both the Chemical Stockpile Program and the Non-Stockpile Chemical Materiel Project. As such, the Army is responsible for the safe and economical disposal of the U.S. stockpile of lethal and incapacitating chemical warfare agents and munitions. The program objective is to destroy the U.S. stockpile of unitary chemical agents and munitions in accordance with the public law and the schedules approved by the Defense Acquisition Decision Memorandum dated September 26, 2001, and updated in the April 2003 Acquisition Program Baseline.

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

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

The DoD has not identified any unamortized portion of the estimated total clean up cost associated with General Property, Plant and Equipment (PP&E). The Department's Financial Management Regulation requires the unamortized clean up cost associated with PP&E to be recognized. The Department is working with the Military Departments to ensure the regulation is properly implemented.

The Department had changes in estimation resulting from overlooked or previously unknown contaminants, better site characterization with sampling, cost avoidance rerun, re-estimation based on different assumptions and/or escalation, and re-estimation of costs based on lessons learned. Regulatory related changes include addition of range rule/munitions requirements, additional or extended long-term monitoring requirements or 5 year reviews, no further action agreement with the regulator, and risk-based corrective action. Technology related changes include additional contamination level sampling, additional or extended remedial action operation, additional sites and incomplete site data, and technical solution changes.

The Active Installations – ER for Closed Ranges increased $3.3 billion (77 percent). The Department of Army reported an increase of $2.6 billion that resulted from additional site level data collected from the Army range inventory. The Department of Navy reported an increase of $241.7 million due to adding 10 new sites at Concord and Seal Beach, California, an estimate increase for Vieques, Puerto Rico, escalation of cost estimates, and cost growth in preliminary findings. The Department of Air Force also reported an increase of $506.7 million that resulted from the identification of 20 additional sites.

Active Installations – Environmental Closure Requirements increased $74.9 million (72 percent). The variance is primarily due to an increase of $45.8 million in the Department of Air Force, $15.0 million in DoD Component Level Accounts, and a $14.1 million increase in the Department of Army. The increase for the Department of Air Force is attributable to a change in the amortization calculation that is now amortizing amounts over the life of an asset rather than assessing the liability in the year of disposal. The increase for the DoD Component Level Accounts is attributable to a reclassification from Other Accrued Environmental Costs (Non-DERP funds) – Other to Active Installations Environmental Closure Requirements. The increase for the Department of the Army is attributable to receipt of an updated Environmental Program Requirements (EPR) report with improved cost estimates and site changes, as well as the addition of previously omitted Class Zero estimates.

Other Accrued Environmental Costs (Non-DERP funds) - Other decreased $40.8 million (81 percent). A decrease of $35 million is attributable to a reclassification from Non-DERP Other to Active Installations-Environmental Restoration and Active Installations-Environmental Closure Requirements within a DoD Component Level

Account. An additional decrease of $1.5 million is also attributable to a reclassification from Non-DERP Other to Active Installations- Environmental Corrective Action within the Defense Threat Reduction Agency (DTRA). The remaining decrease of $4.4 million for the Defense Commissary Agency (DeCA) Surcharge entity is the result of a revised estimate used to calculate the noncurrent environmental clean up costs.

The BRAC Installations – Environmental Restoration (ER) decreased $495.7 million (14 percent). The decrease is primarily due to a $78.6 million increase reported by the Department of Army and a $529.4 million decrease reported by the Department of Air Force. The increase reported by the Department of the Army is due to the increased remediation efforts required. The decrease reported by the Department of Air Force resulted from implementation of a new cost estimating and reporting policy that limits the liability to 25 years of remediation action operations along with five years of long term monitoring.

The BRAC Installations – Environmental Corrective Action liability decreased $20.1 million (11 percent). The variance is primarily due to a decrease of $23.1 million reported by the Department of Army. This decrease reflects changes in cleanup actions required at a site.

Base Realignment and Closure (BRAC) – Other increased $18.9 million (10 percent). The variance is attributable to the Department of Army and reflects additional estimates previously omitted.

Note 15.	Other Liabilities

As of September 30 (Amounts in millions)	2004 Current Liability		2004 Noncurrent Liability		2004 Total		2003 Total	
1. Intragovernmental:								
A. Advances from Others	$	749.6	$	0.0	$	749.6	$	272.5
B. Deposit Funds and Suspense Account Liabilities		561.6		0.0		561.6		372.3
C. Disbursing Officer Cash		2,071.8		0.0		2,071.8		1,509.4
D. Accounts Payable--Cancelled Appropriations		0.0		0.0		0.0		7.0
E . Judgement Fund Liabilities		278.1		101.7		379.8		591.4
F. FECA Reimbursement to the Department of Labor		600.5		831.7		1,432.2		1,420.8
G. Other Liabilities		3,794.8		1,737.1		5,531.9		5,565.7
H. Total Intragovernmental Other Liabilities	$	8,056.4	$	2,670.5	$	10,726.9	$	9,739.1

As of September 30 (Amounts in millions)	2004 Current Liability		2004 Noncurrent Liability		2004 Total		2003 Total	
2. Non-Federal:								
A. Accrued Funded Payroll and Benefits	$	9,581.2	$	1,290.6	$	10,871.8	$	9,118.0
B. Advances from Others		1,741.4		0.2		1,741.6		1,167.3
C. Deferred Credits		4.2		0.0		4.2		9.7
D. Deposit Funds and Suspense Accounts		322.6		0.0		322.6		105.3
E. Temporary Early Retirement Authority		1.0		1.1		2.1		8.5
F. Nonenvironmental Disposal Liabilities:								
(1) National Defense PP&E (Nonnuclear)		0.0		565.8		565.8		574.9
(2) Excess/Obsolete Structures		84.0		351.3		435.3		394.9
(3) Conventional Munitions Disposal		0.0		1,325.9		1,325.9		1,198.8
(4) Other		0.0		0.0		0.0		0.0
G. Accounts Payable Cancelled Appropriations		0.0		0.0		0.0		602.3
H. Accrued Unfunded Annual Leave		7,991.5		0.0		7,991.5		7,645.3
I. Capital Lease Liability		50.5		249.4		299.9		336.4
J. Other Liabilities		9,365.2		1,565.3		10,930.5		8,992.6
K. Total Non-Federal Other Liabilities	$	29,141.6	$	5,349.6	$	34,491.2	$	30,154.0
3. Total Other Liabilities:	$	37,198.0	$	8,020.1	$	45,218.1	$	39,893.1

Fluctuations - Federal

Intragovernmental Other Liabilities Fluctuation Analysis

Intragovernmental Other Liabilities increased $987.8 million (10 percent). The following items contributed to the majority of the overall change:

Advances from Others (Line 1.A.)
Advances from Others increased $477.1 million (175 percent). The Air Force General Fund (GF) increased $478.3 million and is the principal reason for the overall increase. The Air Force increase is due to the timing of the receipt and execution of orders in the Research, Test, Development, and Evaluation (RDT&E) classified program, causing variations in the year-end balances.

Deposit Funds and Suspense Account Liabilities (Line 1.B.)

Deposit Funds and Suspense Account Liabilities increased $189.3 million (51 percent). The following items contributed to the majority of the overall change:

- Navy GF increased $33.6 million. The increase is due to the reclassification of unsupported undistributed collections from accounts payable to other liabilities.
- Army GF increased $69.9 million. The majority is attributable to an increase in the miscellaneous suspense and deposit funds for the following reasons:
  - Increase in Army Member Savings Deposits as a result of an increase in deployed soldiers who are drawing imminent danger pay. The soldiers are authorized to deposit funds and later withdraw the funds with interest.
  - Withheld State Income Taxes
  - Small Escrow Accounts due to the increase of soldiers using the post office and the Army Air Force Exchange Service in Kuwait and Iraq.
- Other Defense Organizations (ODO) GF increased $98.5 million. The increase occurred in the following activities:
  - Thrift Savings Plan Clearing Account: Increase of $43.1 million is related to normal business practices. The government acts in a fiduciary capacity by collecting money from civilian pay, providing matching funds, and disbursing the funds to the plan administrator. The balance in this account is predicated on collections (i.e., the amount of employee participation in a given pay period).
  - Small Escrow Deposit Fund: Increase of $55.4 million is related to normal business practices of the Defense Reutilization Management Office (DRMO). The DRMO is responsible for the disposition of government property. Any remuneration is deposited in the Small Escrow Deposit Fund until transferred to the appropriate organization.

Disbursing Officer Cash (Line 1.C)

Disbursing Officer Cash increased $562.4 million (37 percent). The following items contributed to the majority of the overall change:

- Army GF increased $573.0 million to support Operation Iraqi Freedom and Operation Enduring Freedom.
- Air Force GF increased $37.8 million. The increase is to support Operation Iraqi Freedom.
- Navy GF decreased $48.1 million. The decrease is the result of the Navy drawdown from Operation Iraqi Freedom and subsequent events. The expansion of the ATM at Sea and Navy Cash programs in FY 2004 also contributed to the decrease of Disbursing Officer Cash because Disbursing Officers do not need as much cash on hand.

Accounts Payable - Cancelled Appropriations (Line 1. D)

ODO GF decreased $7.0 million. During FY 2003, Missile Defense Agency's cancelled year unearned revenue was reclassified to accounts payables.

Judgment Fund Liabilities (Line 1.E.)

Judgment Fund Liabilities decreased $211.6 million (36 percent). The majority of the decrease is due to the settlement of claims in litigation as follows:

- Air Force GF decreased $150.3 million because the Air Force reimbursed the Treasury for amounts paid on their behalf.
- Army GF decreased $61.3 million and is based on judgment fund liabilities guidance for the Notification and Federal Employment Antidiscrimination and Retention Act of 2002.
- Navy GF decreased $7.3 million due to aggressive efforts to identify outstanding judgments.

Fluctuations - Non-Federal

Total Non-Federal Fluctuation Analysis

Non-Federal Other Liabilities increased $4.3 billion (14 percent). The following items contributed to the majority of the overall change:

Accrued Funded Payroll and Benefits (Line 2. A.)

Accrued Funded Payroll and Benefits increased $1.8 billion (19 percent). The following items contributed to the majority of the overall change:

- ODO GF increased $1.3 billion. The majority of the change is associated with the increase of "Incurred but not Reported Liability" for the Defense Health Program (DHP). This amount is an estimated liability for medical claims incurred by the DHP, but not reported. The DoD Office of the Actuary developed this estimate based on historical data showing medical claims by incurred date and paid date. This estimate also included factors such as administrative costs associated with the incurred but not reported claims, medical inflation, and the rate of beneficiary utilization of medical services.
- Air Force GF increased $299.6 million. The change is attributable to the increase in the number of military personnel activated in support of the war.

Advances from Others (Line 2.B.)

Advances from Others increased $574.3 million (49 percent). The following items contributed to the majority of the overall change:

- Army GF increased $160.5 million. The increase is due to military construction in South Korea. The U.S.Army Corps of Engineers (USACE) Pacific Ocean Division received these advances that are for various construction projects.
- Navy Working Capital Fund (WCF) increased $282.6 million. The increase is primarily attributable to a reclassification in the component business area in order to adjust for trading partner differences.
- USACE increased $28.9 million. The increase is due to an increase in customer orders from the public. A large percent of the increase in customer orders occurred in the New York and Honolulu districts. The New York district received an advance for the assessment of security of New York City's public water supply and the Honolulu district received advances for a variety of local projects.

Deferred Credits (Line 2.C.)

Deferred Credits decreased $5.5 million (57 percent). The decrease is attributable to the National Defense Stockpile Trust Fund. Deferred credits represent customer payments received for materials that have not yet been shipped. During FY 2004, customers required accelerated deliveries, which resulted in a reduction of deferred credits.

Deposit Funds and Suspense Accounts (Line 2.D.)

Deposit Funds and Suspense Accounts increased $217.3 million (206 percent). The majority of the increase is attributed to the reclassification of unsupported undistributed collections to deposit funds and suspense accounts.

Temporary Early Retirement Authority (Line 2.E.)

Temporary Early Retirement Authority decreased $6.4 million (75 percent). The following items contributed to the majority of the overall change:

- Air Force GF decreased $3.6 million. The decrease is due to the termination of the program.
- Army GF decreased $.3 million. The decrease is due to the termination of the program.
- Navy GF decreased $2.2 million.

Nonenvironmental Disposal Liabilities - Excess/Obsolete Structures (Line 2.F.2.)

Excess/Obsolete Structures increased $40.4 million (10 percent).

- Air Force GF increased $21.3 million. The increase is attributable to the recently completed housing market analysis that better defined the Air Force's surplus of inadequate housing inventory. Modifications in future year demolition strategy account for the change in disposal liability.
- Navy GF increased $19.0 million. The change is a result of additional buildings and facilities/utilities identified for disposal.

Nonenvironmental Disposal Liabilities - Conventional Munitions Disposal (Line 2.F.3.)

Conventional Munitions Disposal decreased $127.1 million (11 percent). The following items contributed to the majority of the overall change:

- Army GF increased $133.0 million due to a stockpile expansion of 7,258 tons.
- Air Force GF decreased $5.9 million. The decrease is due to a policy change during FY 2004 that transferred accounting responsibility for all disposal costs to the Department of the Army for inclusion in its financial statements. The Air Force no longer reports this activity.

Accounts Payable – Cancelled Appropriations (Line 2.G.)

Accounts Payable – Cancelled Appropriations decreased $602.3 million to $0. Cancelled accounts payable was correctly reported as part of other liabilities in FY 2003. Treasury mapping changes implemented in June 2004 required all entities to report cancelled accounts payable as part of accounts payable beginning in the 3rd Quarter of FY 2004.

Capital Lease Liability (Line 2.I)

Capital Lease Liability decreased $36.5 million (11 percent). The following items contributed to the majority of the overall change:

- Air Force GF decreased $28.2 million. The change is the result of a decrease in leases held by the Air Force in FY 2004.
- Army GF decreased $11.7 million. The change is a result of normal payments made against the lease liability.
- ODO GF increased $3.3 million. The change is a result of the increase in leased equipment.

Other Liabilities (Line 2.J.)

Other Liabilities increased $1.9 billion (22 percent). The following items contributed to the majority of the overall change:

- Navy WCF increased $1.1 billion. The majority of the change is due to the reclassification of an abnormal balance and an increase in depot level reparable carcass returns.
- ODO GF increased $1.6 billion. The majority of the change occurred in the Foreign Military Sales (FMS) Trust Fund due to a change in the net custodial cash balance. The custodial liability represents net collections received from the foreign customers less the funds disbursed on their behalf.
- Army GF decreased $712.7 million. The majority of the decrease was attributable to a NATO program, which Army incorrectly reported in FY 2003. For FY 2004, the Other Defense Organizations correctly reported this liability, which resulted in a decrease for Army GF.
- Air Force WCF decreased $278.7 million. The decrease is primarily attributable to the Depot Maintenance Activity Group (DMAG). The phase-out of contracts in the DMAG has resulted in a decline in material, labor, and overhead accruals.

Other Disclosures

In FY 2004 the DoD made a prior period adjustment to reclassify $1.0 billion of undistributed disbursements from other liabilities to cumulative results of operations. See Note 20 for further information.

Intragovernmental Other Liabilities by Entity

Intragovernmental Other Liabilities (Line 1.K) for 4th Quarter, FY 2004 ($millions)			
Entity	**Current Liability**	**Non Current Liability**	**Total Liability**
AF GF	317.6		317.6
AF WCF	8.6		8.6
Army GF	276.8		276.8
Army WCF	6.6		6.6
MRF		0.9	0.9
Navy GF	2,885.0		2,885.0
Navy WCF	42.6		42.6
ODO GF	112.9	10.3	123.2
ODO WCF	20.9		20.9
USACE	123.8	1,725.9	1,849.7
Total	3,794.8	1,737.1	5,531.9

Non-Federal Other Liabilities by Entity

Non-Federal Other Liabilities (Line 2.M.) for 4th Quarter, FY 2004 ($millions)			
Entity	**Current Liability**	**Non Current Liability**	**Total Liability**
AF GF	0.9	308.8	309.7
AF WCF	1,446.5		1,446.5
Army GF	1,051.6	742.2	1,793.8
Army WCF	42.5		42.5
MRF	0.2		0.2

Navy GF	150.6	81.4	232.0
Navy WCF	4,113.7	0.0	4,113.7
ODO GF	2,238.5	429.2	2,667.7
ODO WCF	181.5	3.7	185.2
USACE	139.2		139.2
Total	9,365.2	1,565.3	10,930.5

Capital Lease Liability

As of September 30	2004				2003
	Asset Category				
(Amounts in millions)	Land and Buildings	Equipment	Other	Total	Total
1. Future Payments Due:					
A. 2004	$ 66.2	$ 0.2	$ 0.0	$ 66.4	$ 67.4
B. 2005	65.9	0.1	0.0	66.0	66.4
C. 2006	60.1	1.0	0.0	61.1	66.1
D. 2007	47.5	3.5	0.0	51.0	60.2
E. 2008	43.9	0.0	0.0	43.9	47.5
F. After 5 Years	129.3	0.0	0.0	129.3	184.4
G. Total Future Lease Payments Due	$ 412.9	$ 4.8	$ 0.0	$ 417.7	$ 492.0
H. Less: Imputed Interest Executory Costs	117.8	0.0	0.0	117.8	155.6
I. Net Capital Lease Liability	$ 295.1	$ 4.8	$ 0.0	$ 299.9	$ 336.4
2. Capital Lease Liabilities Covered by Budgetary Resources:				$ 219.4	$ 326.1
3. Capital Lease Liabilities Not Covered by Budgetary Resources:				$ 80.5	$ 127.2

Comparison of Capital Leases between Year-end FY 2003 and FY 2004				
($ amounts in millions)				
Future Payments Due	**YE 2004**	**YE 2003**	**Increase/ Decrease**	**% Change**
A. 2004	66.4	67.4	(1.0)	1.5
B. 2005	66.0	66.4	(0.4)	0.6
C. 2006	61.1	66.1	(5.0)	7.6
D. 2007	51.0	60.2	(9.2)	15.3
E. 2008	43.9	47.5	(3.6)	7.6
F. After 5 Years	129.3	184.3	(55.0)	29.8
G. Total Future Lease Payments Due	417.8	492.0	(74.2)	15.1
H. Less Imputed Interest Executory Costs	117.9	155.6	(37.7)	24.2
I. Net Capital Lease Liability	299.8	336.4	(36.6)	10.9
Capital Lease Liability Covered by Budgetary Resources	219.4	326.1	(106.7)	32.7
Capital Lease Liability Not Covered by Budgetary Resources	80.5	127.2	(46.7)	36.7

For the Department of Defense, all leases prior to FY 1992 are funded on an annual basis and subject to the availability of funds. Non-current amounts for these leases are shown as Not Covered by Budgetary Resources.

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

Note 16. Commitments and Contingencies

Legal Contingencies:

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

For FY 2003, the materiality threshold for reporting litigation, claims, or assessments was $73.4 million and for FY 2004 the threshold was $100.7 million. Cases, meeting this threshold, were reported on the Department's legal representation letter. The amounts reported in the legal representation letter represent the maximum amounts of any potential liability of the Government based on the amounts claimed. Management does not consider it to be at all likely that the Government will be liable for such maximum amounts.

The Department is aggressively contesting the claimed liability of the Government in each of the litigation, claims or assessments in its legal representation letter. Except as indicated below, the Department is unable to predict the likely outcome or the amount of liability because most of the litigation, claims, or assessments are in the preliminary stage. For the case identified below, a loss to the Government is probable. It is likely that the United States will have to pay some amount of damages. It is impossible to predict the outcome of the litigation on the question of damages with any degree of certainty. Therefore, the ultimate liability of the Government on this case and the other reported legal representation letter cases cannot be reasonably estimated at this time.

A contractor filed an appeal with the Armed Services Board of Contract Appeals (ASBCA) in August 1998, of the Contracting Officer's denial of its agency-level claim. The contractor is seeking a total of $279 million ($164 million damages for "value of service" and $115 million damages for "loss of revenues") for government noncompliance on the license agreement during November 1994 through September 1997. A hearing on entitlement was held before the ASBCA in May 2000. The ASBCA issued its decision on March 2001, finding that the Government had breached the terms of the license agreement. The burden is now on the contractor to prove its claimed damages. A hearing on damages has not been scheduled nor has the Defense Contract Audit Agency audited the contractor's claim.

Other Commitments and Contingencies

In addition, the Department has other contingent liabilities primarily consisting of the Chemical Demilitarization Non-Stockpile Disposal of $9 billion (the estimated cost of destroying buried chemical munitions) and Environmental Restoration of $846.7 million. These liabilities are not accrued in the Department's financial statements.

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

As of September 30	2004				2003
	Actuarial Present Value of Projected Plan Benefits	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Actuarial Liability	Unfunded Actuarial Liability
(Amounts in millions)					
1. Pension and Health Benefits:					
A. Military Retirement Pensions	$ 834,582.1	6.25%	$ (181,133.1)	$ 653,449.0	$ 560,032.7
B. Military Retirement Health Benefits	221,242.0	6.25%	0.0	221,242.0	206,839.4
C. Medicare-Eligible Retiree Benefits	504,073.8	6.25%	(38,085.9)	465,987.9	457,987.8
D. Total Pension and Health Benefits	$ 1,559,897.9		$ (219,219.0)	$ 1,340,678.9	$ 1,224,859.9
2. Other:					
A. FECA	$ 6,958.7		$ 0.0	$ 6,958.7	$ 7,596.1
B. Voluntary Separation Incentive Programs	1,593.6	4.0%	(701.6)	892.0	930.1
C. DoD Education Benefits Fund	1,254.5	5.3%	(1,008.1)	246.4	171.1
D. Total Other	$ 9,806.8		$ (1,709.7)	$ 8,097.1	$ 8,697.3
3. Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities:	$ 1,569,704.7		$ (220,928.7)	$ 1,348,776.0	$ 1,233,557.2

Fluctuations

The unfunded liability for Military Retirement Benefits and Other Employment Related Actuarial Liabilities increased $115.2 billion (9 percent). The net increase resulted from an increase in the actuarial liability of $140.1 billion that is offset by an increase of $24.9 billion in the value of assets available to pay benefits.

The unfunded actuarial liability for Military Retirement Pensions increased $93.4 billion (17 percent). The variance is attributable to an increase of $98.5 billion in the overall liability for the Military Retirement Fund (MRF) that is offset by an increase of $5.1 billion in the value of assets available to pay benefits. Additional information is contained in the Military Retirement paragraph.

The unfunded actuarial liability for the DoD Education Benefits Fund increased $75.2 million (44 percent). The increase is the result of an increase in the actuarial liability that is offset by an increase in the value of the assets available to pay benefits. Additional information is discussed in the DoD Education Benefits Fund paragraph.

Other Disclosures

In December 2003, the estimate of the actuarial liabilities as of October 1, 2002, for the covered benefits for the U.S. Coast Guard participants in the Medicare-Eligible Retiree Health Care Fund was revised from $5 billion to $7.8 billion. The increase in the transfer from the U.S. Coast Guard to the Medicare-Eligible Retiree Health Care Fund (MERHCF) of $2.8 billion is recorded on the financial statements as a decrease to the Gross Costs with the Public.

Military Retirement

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

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

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

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

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

Actuarial Cost Method Used: Aggregate entry-age normal method.
Market Value of Investments in Market-Based and Marketable Securities: $199.2 billion

		Amounts (in millions)	
		FY 04	FY 03
A.	Beginning of Year Accrued Liability	$736,061.6	726,915.4
B.	Normal Cost Liability	12,857.2	13,719.4
C.	Plan Amendment Liability	81,062.7	880.3
D.	Assumption Change Liability	(32.5)	(4,626.3)
E.	Benefit Outlays	(36,623.5)	(35,716.8)
F.	Interest on Pension Liability	45,272.4	44,755.2
G.	Actuarial Loss (Gain)	(4,015.8)	(9,865.7)
H.	End-of-Year Accrued Liability (A+B+C+D+E+F+G)	$834,582.1	$736,061.6
I.	Net Change in Actuarial Liabilities (B+C+D+E+F+G)	$98,520.5	$9,146.2

Military Retirement Health Benefits (MRHB)

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

Change in Defense Health Program MRHB Actuarial Liability

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

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

Medical Trend

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

Other Information

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

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

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

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

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

Medicare-Eligible Retiree Benefits

The unfunded actuarial liability increased $8 billion. The increase is attributable to an increase of $27.9 billion in the actuarial liability that is offset by an increase of $19.9 billion in the value of assets available to pay benefits.

Changes in MERHCF Actuarial Liability

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

Assumptions in Calculation of MERHCF Liability
Interest Rate: 6.25%

Medical Trend

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

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

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

FY 2003 Service contributions to the MERHCF were:

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

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

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

The actuarial liability reported above does not include $491.3 million in incurred but not reported liabilities as of September 30, 2004. These liabilities are disclosed in the Liabilities Not Covered and Covered by Budgetary Resources note, and the Other Liabilities note.

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

Actuarial Cost Method Used for MERHCF Liability: Aggregate Entry-Age Normal
Market Value of Investments in Market-Based and Marketable Securities: $39.2 billion

Federal Employees Compensation Act (FECA)

The unfunded liability for FECA decreased 8 percent.

Assumptions

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

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

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

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

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

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

Voluntary Separation Incentive Programs (VSI)

The unfunded actuarial liability decreased $38.1 million. The decrease is the net result of a decrease of $96.5 million in the actuarial liability, and a decrease of $58.4 million in the value of assets available to pay benefits.

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

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

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

Market Value of Investments in Market-based and Marketable Securities: $731.2 million.

DoD Education Benefits Fund

The 44 percent increase in the DoD Education Benefits unfunded actuarial liability is the combined result of an increase of $46.4 million in the actuarial present value of the plan benefits, and a decrease of $28.7 million in the value of the assets available to pay benefits. The modified estimate of the present value of benefits (PVB) for the DoD Education includes more complete experience. The increase in the actuarial liability is the result of an increase of $64 million due to an additional year of new entrants and calculating the present value of the stream of projected future benefits as of a year later, and a PVB decrease of $18 million related to a higher interest rate assumption (5.3 percent versus 4.4 percent).

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

Market Value of Investments in Market-based and Marketable Securities: $1 billion

Note 18. Unexpended Appropriations

As of September 30		2004		2003
(Amounts in millions)				
1. Unexpended Appropriations:				
A. Unobligated, Available	$	45,234.9	$	56,764.8
B. Unobligated, Unavailable		14,434.3		5,069.9
C. Unexpended Obligations		184,144.7		157,034.8
D. Total Unexpended Appropriations	$	243,813.9	$	218,869.5

Unexpended appropriations represent the amount of budget authority remaining for disbursement against current or future obligations. Unobligated balances represent the cumulative amount of budgetary authority that has not been set aside to cover outstanding commitments and obligations. Unobligated balances are classified as available or unavailable. Unobligated balances associated with appropriations expiring at fiscal year-end remain available only for obligation adjustments until the account is closed. Unexpended obligations represent funds that have been obligated for goods that have not been received or services that have not been performed.

Unexpended Obligations reported as a component of Unexpended Appropriations include both Undelivered Orders-Unpaid and Undelivered Orders-Paid for direct appropriated funds only. This amount is distinct from line 12, Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but Not Yet Provided, on the Statement of Financing. Line 12 includes the change during the fiscal year in Unexpended Obligations against budget authority from all Military Services.

Fluctuations

Unexpended Appropriations increased $24.9 billion (11 percent). This increase is primary the result of a 6 percent increase in Appropriations Received by the Department of Defense.

Unobligated, Available decreased $11.5 billion (20 percent) and evidenced an emphasis on obligating available funds. This decrease directly impacted the Unexpended Obligations which increased $27.1 billion (17 percent). The $15.6 billion difference between the two accounts is shown in Undelivered Orders reported on the Statement of Budgetary Resources.

Unobligated, Unavailable increased $9.4 billion (185 percent). An increase of $6.4 billion is mainly attributable to Title IX of the Department of Defense Appropriations Act that provided additional funding for FY 2004 and FY 2005. The additional funding is to support antiterrorism base operations and force protection needs, training, recruiting, and security requirements. The $6.4 billion of Unavailable balances will become available for obligation in FY 2005. The remaining increase of $1.3 billion is attributable to appropriation authority that is canceled 5 years after the funds are in an expired status.

Note 19. Statement of Net Cost

This statement provides gross and net cost information that can be related to the amount of output or outcome for a given program and/or organization administered by a responsible reporting entity.

For General Funds, the amounts presented in the Statement of Net Cost (SoNC) are based on obligations and disbursements and therefore may not, in all cases, reflect actual accrued costs. While the Department's Working Capital Funds (WCFs) generally record transactions on an accrual basis, the systems do not always capture actual costs in a timely manner. As such, information presented in the SoNC is based on budgetary obligation, disbursement, and collection transactions, as well as non-financial feeder systems, adjusted to record known accruals for major items such as payroll expenses, accounts payable, and environmental liabilities.

Fluctuations

Intragovernmental Gross Costs increased $11.8 billion (101 percent).

The Army GF increased by $5.4 billion as a result of the Presidential approval of the Emergency Wartime Supplemental Appropriations Act (PL 108-11). Congressional funding for the global war on terror was received through appropriated and supplemental funding in FY 2004. An increase in Operation and Maintenance appropriations funded approximately one-third of antiterrorism base operations and force protection needs.

The Air Force GF and Navy GF increased $2.7 billion and $4.1 billion respectively, resulting from recognizing expenses from the Intragovernmental Reporting and Analysis System (IRAS) that were not recognized in prior years. The IRAS allows the military services to better compare trading partner activity with other Federal agencies. As a result, the Air Force GF and Navy GF were able to identify and record expenses with these agencies in FY 2004.

Intragovernmental Earned Revenue increased $2.2 billion (17 percent).

The Medicare-Eligible Retiree Health Care and the Military Retirement Funds increased $768.6 million and $126.3 million, respectively. These increases resulted from increased interest and investment balances during FY 2004.

The Air Force GF increased $626.3 million due to larger spending authority earned in the O&M and RDT&E appropriations. The O&M increase was due to a concerted effort in August and September 2004, at the Major Command level to properly code the reimbursable transactions in the accounting system to better reflect the total amount of goods and services provided to other DoD organizations.

USACE's $128.5 million increase is attributed to improvements to its process of identifying trading partner elimination data for other Corps revenue in the revolving fund. The Corps developed system queries to identify trading partners for labor and other transactions reimbursed from military and other civil appropriations. Revenue had previously been included as intra-entity eliminations.

Gross Costs with the Public increased $93.3 billion (18 percent).

The Army GF increased by $24.1 billion as a result of the Presidential approval of the Emergency Wartime Supplemental Appropriations Act (PL 108-11). Congressional funding for the global war on terror was received through appropriated and supplemental funding in FY 2004. The increase supports the incremental costs of Reserve forces on active duty in a war zone versus peacetime training. Additionally, the military pay appropriations received a 3.7 percent pay increase for all soldiers and a pay raise of up to 6.25 percent for selected military pay grades.

Medicare Eligible Retiree Health Care Fund decreased $38.2 billion. During FY 2003, a one-time charge was incurred to cumulatively include reservists' benefits in the actuarial liability that had previously been omitted. The expense caused a sharp increase in FY 2003, which resulted in a negative variance when compared to FY 2004 expenses.

Military Retirement Fund increased $91.1 billion because of amendments by the 2004 National Defense Authorization Act for the new concurrent receipt benefits resulting in a substantial plan amendment liability increase in FY 2004.

The Navy GF increased $15.7 billion. This is a result of an increase in depreciation costs from recognizing Military Equipment in FY 2003 and continuing into FY 2004 and an increase in depreciation costs for buildings, structures, and utilities resulting from changes to the depreciation model used.

Earned Revenue from the Public increased $9.8 billion (79 percent).

The re-mapping of the USSGL Account 7190, Other Gains, from the Gross Cost with the Public line to the Earned Revenue from the Public line during FY 2004 has caused an increase. In prior years, these gains were not included with Earned Revenue from the Public. This re-mapping caused increases in the Army WCF of $4.5 billion, the Navy GF of $1.4 billion, and Air Force GF of $995.4 million. Defense Logistics Agency GF had an increase of $853.0 million related to increased energy cost and additional requirements for supplies for increased troop support.

Gross Cost and Earned Revenue by Budget Functional Classification

As of September 30 (Amounts in millions) Budget Functional Classification	2004 Gross Cost	2004 (Less: Earned Revenue)	2004 Net Cost	2003 Net Cost
1. Department of Defense Military (051)	$ 468,482.6	$ (25,481.7)	$ 443,000.9	$ 401,028.9
2. Water Resources by U.S. Army Corps of Engineers (301)	9,427.1	(977.5)	8,449.6	9,308.0
3. Pollution Control and Abatement by US. Army Corps of Engineers (304)	124.9	0.0	124.9	140.2
4. Federal Employees Retirement and Disability, Department of Defense Military Retirement Fund (602)	135,662.9	(10,124.7)	125,538.2	34,547.5
5. Veterans Education, Training, and Rehabilitation by Department of Defense Education Benefits Trust Fund (702)	317.1	(35.8)	281.3	285.4
6. Medicare Eligible Retiree Health Care Fund (551)	29,133.7	(1,163.7)	27,970.0	66,980.6
7. Total	$ 643,148.3	$ (37,783.4)	$ 605,364.9	$ 512,290.6

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

As of September 30	2004			2003
(Amounts in millions)	Gross Cost to Generate Intra-governmental Revenue	(Less: Earned Revenue)	Net Cost	Net Cost
Budget Functional Classification				
1. Department of Defense Military (051)	$ 22,410.5	$ (3,495.2)	$ 18,915.3	$ 8,409.5
2. Water Resources by U.S. Army Corps of Engineers (301)	890.8	(609.6)	281.2	277.4
3. Pollution Control and Abatement by US. Army Corps of Engineers (304)	2.5	0.0	2.5	2.4
4. Federal Employees Retirement and Disability Department of Defense Military Retirement Trust Fund (602)	0.0	(10,124.7)	(10,124.7)	(9,998.4)
5. Veterans Education, Training, and Rehabilitation by Department of Defense Education Benefits Trust Fund (702)	270.7	(35.8)	234.9	213.5
6. Medicare Eligible Retiree Health Care Fund (551)	0.0	(1,163.7)	(1,163.7)	(395.1)
7. Total	$ 23,574.5	$ (15,429.0)	$ 8,145.5	$ (1,490.7)

The Department's accounting systems do not capture cost data in a manner that enables the Department to determine if the cost was incurred to generate intragovernmental revenue. Therefore, the Department was unable to complete this note. The Department is in the process of upgrading its financial and feeder systems and will be addressing this issue.

Benefit Program Expenses

(Amounts in millions)	2004	2003
1. Service Cost	$ 30,466.8	$ 28,100.2
2. Period Interest on the Benefit Liability	88,107.0	82,253.8
3. Prior (or past) Service Cost	81,062.7	880.3
4. Period Actuarial Gains or (Losses)	6,086.0	20,509.8
5. Gains/Losses Due to Changes in Medical Inflation Rate Assumption	(15,421.2)	9,206.0
6. Total Benefit Program Expense	$ 190,301.3	$ 140,950.1

Amounts for Foreign Military Sales (FMS) Program Procurements from Contractors

Revenue and expense amounts pertaining to FMS items provided by DoD contractors are not reported in the Statement of Net Cost. However, we estimate the amount of such revenue and expense to be $8 billion (80 percent of $10 billion CFY Trust Funds Disbursed). A Statement of Custodial Activity is provided which reports the amounts of cash collections and disbursements of the FMS Trust Fund through the 4th Quarter FY 2004.

Stewardship Assets

Stewardship assets include Heritage Assets, Stewardship Land, Non-Federal Physical Property, and Investments in Research and Development. The current-year cost of acquiring, constructing, improving, reconstructing or renovating stewardship assets are included in the SoNC. Material yearly investment amounts related to stewardship assets are provided in the Required Supplemental Stewardship Information section of this financial statement.

Suborganization Program Costs

The Department of Defense (DoD) is in the process of reviewing available data and attempting to develop a cost reporting methodology that fulfills the need for cost information required by SFFAS No. 4. Until cost-allocating processes and expanded intra-DoD eliminating capabilities are incorporated into the accounting processes, the usefulness of further sub-organization-reported (major command) net costs is limited. Therefore, no additional statements of sub-organization cost at lower levels are presented with these statements.

Note 20.	Statement of Changes in Net Position

As of September 30	Cumulative Results of Operations 2004	Unexpended Appropriations 2004	Cumulative Results of Operations 2003	Unexpended Appropriations 2003
(Amounts in millions)				
1. Prior Period Adjustments Increases (Decreases) to Net Position				
Beginning Balance:				
A. Changes in Accounting Standards	$ 699.5	$ 0.0	$ 383,130.0	$ 0.0
B. Errors and Omissions in Prior Year Accounting Reports	(14,543.3)	25,913.7	11,524.4	0.0
C. Other Prior Period Adjustments	(1,044.7)	0.0	(1,044.7)	0.0
D. Total Prior Period Adjustments	$ (14,888.5)	$ 25,913.7	$ 393,609.7	$ 0.0
2. Imputed Financing:				
A. Civilian CSRS/FERS Retirement	$ 1,658.6	$ 0.0	$ 1,717.2	$ 0.0
B. Civilian Health	2,248.7	0.0	1,948.4	0.0
C. Civilian Life Insurance	22.4	0.0	20.9	0.0
D. Judgment Fund	162.8	0.0	180.4	0.0
E. Total Imputed Financing	$ 4,092.5	$ 0.0	$ 3,866.9	$ 0.0

Prior Period Adjustments

The Department of Defense recorded $14.8 billion (net) in prior period adjustments to Cumulative Results of Operations (CRO) and $25.9 billion to Unexpended Appropriations. These adjustments consist of the following:

During FY 2003, the Navy General Fund overstated Appropriations Used by $25.9 billion, resulting in an overstatement of CRO and an understatement of Unexpended Appropriations. In FY 2004, the Navy General Fund recorded a prior period adjustment (restated) to the beginning CRO and Unexpended Appropriations balances, moving the $25.9 billion from CRO to Unexpended Appropriations.

In FY 2004, the Air Force Working Capital Fund continued to change its inventory valuation method from Latest Acquisition Cost to Moving Average Cost. The result of these changes were a prior period adjustment (restated) of $0.7 billion to clear the Inventory-Allowance account, and a prior period adjustment (restated) of $11.3 billion that was posted to resolve accumulated errors from previous years.

In December 1994, the Office of the Under Secretary of Defense (Comptroller), OUSD(C), decentralized cash management responsibilities. In this decentralization, the Navy Working Capital Fund received $1.0 billion in undistributed disbursements. During FY 2004, DoD reclassified this amount from Other Liabilities to Cumulative Results.

All adjustments comply with guidance provided by SFAS 16, APB 20, and SFFAS No.21, all of which address the treatment of errors and disclosure of prior period adjustments.

Imputed Financing

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

Fluctuations

Cumulative Results of Operations

There were no rescissions or Other Adjustments (Line 4.C.) impacting Budgetary Financing Sources.

Budgetary Financing Sources, Appropriations Used (Line 4.D.) increased $47.1 billion due to the recognition of Iraqi transfer accounts that do not require budgetary entries because the budgetary impact of the transfer accounts is reported by the transferring entity. The United States Army Corps of Engineers (USACE) will use these funds for reconstruction in Iraq.

Budgetary Financing Sources, Nonexchange Revenue (Line 4.E.) increased $0.5 billion due to the collection of taxes and interest into the USACE Trust Fund.

Budgetary Financing Sources, Donations and Forfeitures of Cash and Cash Equivalents (Line 4.F.) decreased $.02 billion due to a reduction in donations.

Budgetary Financing Sources, Transfers-in/out Without Reimbursement (Line 4.G.) increased $9.2 billion due largely to the transfer in of funds from the Executive Office of the President for Iraqi Relief and Reconstruction Fund.

Budgetary Financing Sources, Other Budgetary Financing Sources (Line 4.H.) increased $7.9 billion. The increase represents adjustments to bring the proprietary accounts into agreement with the budgetary accounts. Due to system deficiencies, there are unreconciled differences between the budgetary and proprietary trial balances. The net effect of these adjustments is reflected in Other Budgetary Financing Sources on the Statement of Net Position.

Other Financing Sources, Donations and Forfeitures of Property (Line 5.A.) decreased $4.0 million as a result of an overall decrease in donations and forfeitures of property.

Other Financing Sources, Transfers-in/out without reimbursement (Line 5.B.) increased by $3.9 billion. The majority of the difference was attributable to the Medicare-Eligible Retiree Health Care Fund (MERHCF). In December 2003, the estimate of the actuarial liabilities as of October 1, 2002 for the covered benefits for the U.S. Coast Guard participants in the MERHCF was revised from $5.0 billion to $7.8 billion. The increase in the transfer from the U.S. Coast Guard to the MERHCF of $2.8 billion was recognized in the 1st Quarter, FY 2004.

Other Financing Sources, Other (Line 5.D.) decreased by $0.3 billion due to a change in the accounting treatment for collections in the General Fund Proprietary Interest Receipt Account. Due to the change, a contra revenue account was established.

Unexpended Appropriations

Overall, Budgetary Financing Sources have increased due to the global war on terror (GWOT). Since March 2003, Congress has approved supplemental funding and increased the Department's FY 2004 appropriations to support these efforts in addition to the war in Iraq. This increased funding supports war-fighting readiness, force protection, procurement of helicopters, development of future combat systems, and war reserves. The additional funding also supports the incremental costs of Reserve forces on active duty in a war zone versus peacetime training. The increased appropriations also support antiterrorism base operations, training, recruiting, and security.

Note 21.	Statement of Budgetary Resources

As of September 30	2004	2003
(Amounts in millions)		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 233,505.4	$ 215,000.2
2. Available Borrowing and Contract Authority at the End of the Period	25,314.3	21,150.6

Fluctuations

The Net Amount of Budgetary Resources Obligated for Undelivered Orders increased $18.5 billion (8.6 percent). This increase was mainly due to an increase in FY 2004 budget authority. This increase was directly influenced by the Emergency Wartime Supplemental Appropriations Act that was approved in FY 2003, and the congressional funding for the global war on terror (GWOT) received in FY 2004.

Available Borrowing and Contract Authority at the End of the Period increased a net of $4.1 billion (19.7 percent). This increase was mainly attributable to the increased authority to buy spares to support increased maintenance efforts in support of the contingency missions Operations Enduring Freedom, Iraqi Freedom, and Noble Eagle and to incur obligations for foreign military sales administrative expenses.

Before the war in Iraq began in March 2003, the Department of Defense (DoD) had been supporting the GWOT. Since March 2003, the Congress has approved supplemental funding and increased the Department's FY 2004 appropriations to support the GWOT in addition to the war in Iraq. Accordingly, most of the Statement of Budgetary Resources (SBR) line items changed substantially due to funding provided for the GWOT which includes, but is not limited to, Operations Enduring Freedom, Iraqi Freedom, and Noble Eagle. This increased funding supports war-fighting readiness, force protection, procurement of helicopters, development of future combat systems, and war reserves. The additional funding also supports the incremental costs of Reserve forces serving on active duty in a war zone rather than during peacetime training. The military members received an across-the-board 3.7 percent base pay increase plus a pay raise of up to 6.25 percent for certain military pay grades. The Congress also increased the rates for incentive pay, family separation allowance, and special pay for duty subject to hostile fire or imminent danger. These increased appropriations also support antiterrorism base operations and force protection needs, training, recruiting, and security requirements.

The SBR also reflects an increase in borrowing authority. This authority is used for capital improvements to the Washington DC Aqueduct. Local jurisdictions provide funding to repay the debt. The borrowing authority that was converted to cash was not correctly recorded for FYs 2000 and 2001. The Department made an adjustment in the 4th Quarter, FY 2004 to reflect this correction.

The Department reported a significant increase in net transfers of budget authority, net transfers of unobligated balances, advances received, funds permanently not available, and unobligated balances not available. The majority of the net transfers of budget authority represent transfers for the operating expenses of the Coalition Provisional Authority in Iraq, first reported during 4th Quarter, FY 2003, and increased activity due to the increased funding received in support of Operations Enduring Freedom, Iraqi Freedom, Noble Eagle, and Army Transformation. The majority of the net transfers of unobligated balances represent funds that were transferred to Operation and Maintenance from the Operation Iraqi Freedom Fund and the Iraqi Relief and Reconstruction Fund. The advances received represent the increase in reimbursable authority related to the support of land force readiness, including environmental conservation, pollution prevention, and base communications. The funds permanently not available represent the enacted rescissions of prior-year funds from the Operation Iraqi Freedom Fund. The increase in unobligated balances not available is attributable to both the Iraqi Freedom Fund and the classified components.

The nonbudgetary section of the SBR, which reports activity for the Military Housing Privatization Initiative, reflected significant variances regarding borrowing authority, net transfers of unobligated balances, receivables and collections related to spending authority from offsetting collections, and funds permanently not available. Those variances were due to the authority to borrow from the Treasury for new direct loans that did not exist in FY 2003; accounting errors made in FY 2003, but corrected in FY 2004; and the obligation, but not liquidation, of these new direct loans.

Other Information Related to the Statement of Budgetary Resources

Permanent Indefinite Appropriations

The Department of Defense received the following permanent indefinite appropriations:

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

Reconciliation Differences

There is a difference of $4.7 billion between undelivered orders (UDOs) reported on line 1 above ($233.5 billion) and the amount of UDOs reported on line 14C, Undelivered Orders, on the SBR ($228.8 billion). This difference is mainly attributable to the process of reporting UDOs with advances. Line 1 reports UDOs with advances, but the SBR does not. Both lines include upward and downward adjustments of prior-year UDOs. In addition, the SBR reports transferred obligations for UDOs without advances, but line 1 above does not.

There is a difference of $69.8 billion between appropriations received that are reported on the SBR ($582.0 billion) and appropriations received that are reported on the Statement of Changes in Net Position ($512.2 billion). This difference is attributable to the process used by the Trust Funds in accounting for their receipts in USSGL account 4114, Appropriated Trust or Special Fund Receipts. Generally, Trust Funds do not receive appropriations.

The Department of the Treasury issues annual warrants to pay amortized amounts for the unfunded actuarial liabilities for the Military Retirement Trust Fund (MRF) and the Medicare-Eligible Retiree Health Care Fund (MERHCF). These amounts are credited to the Other Defense Organizations (ODO) - General Funds and expended from this General Fund to the MRF and MERHCF in accordance with the Office of Management and Budget (OMB) guidance.

Amounts recorded as Appropriations Received, excluding interest earned, on the Statement of Budgetary Resources for the Medicare Eligible Retiree Health Care Fund, the Military Retirement Fund, the Education Benefits Fund, and the Voluntary Separation Incentive Program are also reported as Appropriations Received by the Army, Navy, Air Force, and Other Defense Organizations General Funds, because of the way the funds are received from the Department of the Treasury. The Office of Management and Budget is aware and approves of this duplicate reporting. Ongoing discussions with OMB and the Department of the Treasury have resulted in a change for MERHCF so that this duplication will not occur in future reporting periods. However, there is no planned resolution for MRF.

Intra-entity Transactions

The SBR includes intra-entity transactions because the statements are presented as combined and combining.

Apportionment Categories

Direct Obligations – Apportionment Categories

Reporting Entity	Category A ($millions)	Category B ($millions)	Exempt from Apportionment ($millions)
Army General Fund	148,242.2	4,348.7	
Navy General Fund - see disclosure	132,268.5		
Air Force General Fund	74,410.9	55,500.3	2.1
Air Force Working Capital Fund – see disclosure	2.0		
US Army Corps of Engineers	5,571.0		44.2
Military Retirement Fund	37,152.6		
Medicare-Eligible Retiree Health Care Fund	5,196.8		
Other Defense Organizations – General Fund	103,590.3	814.6	
Other Defense Organizations – Working Capital Fund	1,106.1		
Totals	507,540.4	60,663.6	46.3

Reimbursable Obligations – Apportionment Categories

Reporting Entity	Category A ($millions)	Category B ($millions)	Exempt from Apportionment ($millions)
Army General Fund	23,475.0		
Navy General Fund - see disclosure	8,886.3		
Air Force General Fund	1,101.0	3,346.4	
Army Working Capital Fund	14,006.2		
Navy Working Capital Fund		24,316.4	
Air Force Working Capital Fund – see disclosure	17,272.0		
US Army Corps of Engineers	5,456.3		1.5
Other Defense Organizations – General Fund – see disclosure	3,992.4		
Other Defense Organizations – Working Capital Fund	50,805.5		
Totals	124,994.7	27,662.8	1.5

Note 22.	Statement of Financing

Statement of Financing Adjustments

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

	(in millions)
Resources That Finance the Acquisition of Assets	$ 7,723.3
Other Components Not Requiring or Generating Resources	$ 1,838.7
Revaluation of Assets or Liabilities	$ 498.6
Statement of Net Cost*	$ 11.1

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

Fluctuations

Transfers In/Out Without Reimbursement decreased by $3.9 billion primarily due to the reduction of transfer-in amounts from other federal agencies. In FY 2003 the U.S. Coast Guard and National Oceanic and Atmospheric Administration (NOAA) transferred $6.6 billion in actuarial liabilities to the Medicare-Eligible Retiree Health Care Fund. In FY 2004 the U.S. Coast Guard revised their estimate and transferred an additional $2.8 billion to the fund.

Resources That Fund Expenses Recognized in Prior Period relates to the reduction in the estimates for unfunded liabilities. The $2.0 billion decrease in unfunded liabilities is due primarily to the reduction in environmental liabilities by the Department of Air Force, contingent liabilities by the Department of the Army, and FECA liabilities by the Department of Navy. For further disclosure, see Note 14 for environmental liabilities, Note 15 for contingent liabilities and Note 17 for FECA unfunded liabilities. Corrections to properly classify decreases in unfunded liabilities also contributed to the variance.

Resources That Finance the Acquisition of Assets increased by $14.0 billion due to $ 2.2 billion of new acquisitions by U.S. Special Operations Command (SOCOM), and actions to correctly report expenses within the statement. In FY 2004 actions were taken to discontinue the netting of cost of goods sold against inventory purchases, resulting in a $ 40.0 billion increase in inventory acquisition. This increase was partially offset by the $32.4 billion decrease in acquisition of military equipment by Army, Navy, and Air Force General Funds. U.S. Army Corps of Engineers corrected the reporting of asset transfers and revaluation, resulting in an additional $3.1 billion increase. Increases in acquisitions appear as a negative amount on the Statement of Financing because budgetary expenditures for assets that are capitalized on the Balance Sheet are subtracted from total obligations in order to reconcile budgetary obligations with the net cost of operations.

Other Resources That Do Not Offset Net Cost of Operations – Other consists primarily of a $2.8 billion liability transferred in from the U.S. Coast Guard to the Medicare-Eligible Retiree Health Care Fund. Other Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations are primarily an offset to Transfers-In/Out Without Reimbursement.

Components Requiring Resources in Future Periods – Other consists of unfunded expenses relating to contingent liabilities, actuarial and other unfunded employment-related liabilities. The $43.7 billion increase resulted primarily from changes in actuarial liabilities for the Military Retirement Fund, Medicare-Eligible Retiree Health Care Fund, and the Defense Health Program.

The $13.0 billion decrease in depreciation and amortization was due primarily to decreases in depreciation reported by the Department of the Army, the Department of the Air Force, and U.S. Special Operations Command.

Revaluation of Assets or Liabilities decreased $12.0 billion, primarily due to the implementation of the General Accounting and Finance System – Rehost (GAFS-R) by the Air Force General Fund. The implementation resulted in a decrease of $2.6 billion in reporting gains and losses on inventory valuation. The Air Force Working Capital Fund reported a decrease of $5.7 billion that resulted from correctly reporting gains and losses on inventory valuation. The Navy General Fund reported a decrease of $2.1 billion primarily due to a decrease in the amount of operating materials and supplies used for Operations Enduring Freedom and Iraqi Freedom in FY 2004.

Components Not Requiring Resources in Future Periods – Other consists of expenses not requiring budgetary resources reported by the Department of the Army for the Iraqi Relief and Reconstruction Fund, the adjustment by the Other Defense Organization General Fund to bring the Statement of Financing into balance with the Statement of Net Cost, write-off of capitalized non-federal cost share projects by the U.S. Army Corps of Engineers, and the Air Force Working Capital Funds' adjustment to correctly report cost of good sold in the statements.

Note 23. Statement of Custodial Activity

During Operation Iraqi Freedom, the U.S. Government seized assets from the Iraqi Government that will be used in support of the Iraqi people. As of September 30, 2004, $113.4 million of monetary seized assets remain to be disbursed in support of the Iraqi people. The Statement of Custodial Activity displays only the current year activity. During FY 2004 Iraqi cash disbursed exceeded the amount seized by $164.7 million. The $690.6 million decrease in Seized Iraqi Cash, the $247.8 million decrease in Seized Assets Disbursed on behalf of Iraqi People, and the $442.8 million decrease in Seized Assets Retained for Support of the Iraqi People are due to the Army seizing and disbursing less Iraqi assets in FY 2004.

Seized Iraqi Cash

	(in millions)	
	During FY 2004	**Cumulative from inception**
Source of Collections		
Seized Iraqi Cash	$ **118.3**	$ **927.2**
Disposition of Collections		
Iraqi Salaries	0.7	30.9
Repair/Reconstruction/Humanitarian Assistance	273.0	443.6
Iraqi Ministry Operations (Ministry of Finance, etc.)	9.3	263.9
Fuel/Supplies	0.0	75.4
Total Disbursed on behalf of the Iraqi People	283.0	813.8
Retained for Future Support of the Iraqi People	(164.7)	113.4
Total Disposition of Collections	**118.3**	**927.2**
Net Custodial Collection Activity	$ 0.0	$ 0.0

Fluctuations

The increase in the line for Deposits by Foreign Governments of $1.3 billion (12.7 percent) is primarily due to increase in cash received for the Foreign Military Sales (FMS) programs.

The increase in the line Increase in Amounts to be Transferred of $1.4 million (946 percent) is primarily due to the net increase in custodial cash (collection sources less disposition) in FY 2004 for the FMS Trust Fund and represents a custodial liability. This amount is comprised of collections received from the foreign customers less the funds disbursed on their behalf.

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

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

Note 24.	Other Disclosures

Operating Leases – DoD as Lessee

As of September 30										
	2004								2003	
(Amounts in millions)										
Future Payments Due: Fiscal Year		Land and Buildings		Equipment		Other		Total		Total
2005	$	141.6	$	0.2	$	114.8	$	256.6	$	96.6
2006		140.3		0.0		117.1		257.4		95.5
2007		141.6		0.0		119.5		261.1		97.5
2008		139.4		0.0		121.8		261.2		98.5
2009		139.3		0.0		124.3		263.6		97.4
After 5 Years		64.1		0.0		0.0		64.1		73.5
Total Future Lease Payments Due	$	766.3	$	0.2	$	597.5	$	1,364.0	$	559.0

Fluctuations

The increase of $805 million (144 percent) in total future lease payments due is attributable to two main causes. The first is an increase in the number of high-cost leases entered into by the Air Force in support of contingency operations for the war effort as reflected in the Other category. The second cause reflects the Department’s efforts to establish and refine the estimated cost of the remaining leases and expiration of leases for the Land and Buildings category.