

Department of Defense  
Agency Wide  
**CONSOLIDATED BALANCE SHEET**  
As of June 30, 2007 and 2006

|   | <b>2007 Consolidated</b>            | <b>2006 Consolidated</b>            |
|---|-------------------------------------|-------------------------------------|
|   | <hr/>                               | <hr/>                               |
| <b>1. ASSETS (Note 2)</b>   |                                     |                                     |
| A. Intragovernmental:   |                                     |                                     |
| 1. Fund Balance with Treasury (Note 3)                                    |                                     |                                     |
| a. Entity   | \$ 535,615,564,173.91               | \$ 456,746,551,741.25               |
| b. Non-Entity Seized Iraqi Cash   | 28,418,282.11                       | 35,898,732.31                       |
| c. Non-Entity-Other   | 10,569,834,430.34                   | 2,951,519,889.45                    |
| 2. Investments (Note 4)   | 338,975,100,861.53                  | 303,738,885,213.92                  |
| 3. Accounts Receivable (Note 5)   | 1,630,933,213.63                    | 3,747,095,998.91                    |
| 4. Other Assets (Note 6)  | 1,367,262,901.08                    | 1,189,083,823.21                    |
| 5. Total Intragovernmental Assets   | <hr/> \$ 888,187,113,862.60         | <hr/> \$ 768,409,035,399.05         |
| B. Cash and Other Monetary Assets (Note 7)                                | \$ 14,998,465,166.19                | \$ 2,028,885,274.16                 |
| C. Accounts Receivable, Net (Note 5)                                      | 7,843,906,098.24                    | 8,252,007,385.63                    |
| D. Loans Receivable (Note 8)  | 3,201,999,048.40                    | 3,900,920,915.25                    |
| E. Inventory and Related Property, Net (Note 9)                           | 221,635,774,072.39                  | 225,636,187,337.89                  |
| F. General Property, Plant and Equipment, Net (Note 10)                   | 467,930,357,451.34                  | 447,929,383,892.75                  |
| G. Investments (Note 4)   | 1,359,615,130.00                    | 921,823,130.00                      |
| H. Other Assets (Note 6)  | 36,968,773,371.55                   | 24,894,005,300.90                   |
| <b>2. TOTAL ASSETS</b>  | <hr/> <hr/> \$ 1,642,126,004,200.71 | <hr/> <hr/> \$ 1,481,972,248,635.63 |
| <b>3. LIABILITIES (Note 11)</b>   |                                     |                                     |
| A. Intragovernmental:   |                                     |                                     |
| 1. Accounts Payable (Note 12)   | \$ 1,854,342,538.79                 | \$ 2,216,027,051.25                 |
| 2. Debt (Note 13)   | 3,498,323,940.62                    | 4,155,375,436.63                    |
| 3. Other Liabilities (Note 15 & 16)                                       | 12,676,486,384.38                   | 12,208,136,559.73                   |
| 4. Total Intragovernmental Liabilities                                    | <hr/> \$ 18,029,152,863.79          | <hr/> \$ 18,579,539,047.61          |
| B. Accounts Payable (Note 12)   | \$ 24,833,351,059.27                | \$ 27,256,142,870.83                |
| C. Military Retirement and Other Federal<br>Employment Benefits (Note 17) | 1,816,527,036,649.05                | 1,736,057,882,163.49                |
| D. Environmental and Disposal Liabilities (Note 14)                       | 72,319,378,522.63                   | 72,227,327,019.76                   |
| E. Loan Guarantee Liability (Note 8)                                      | 37,532,452.63                       | 30,572,755.03                       |
| F. Other Liabilities (Note 15 & Note 16)                                  | 59,779,403,469.15                   | 30,513,589,669.98                   |
| <b>4. TOTAL LIABILITIES</b>   | <hr/> \$ 1,991,525,855,016.52       | <hr/> \$ 1,884,665,053,526.70       |
| <b>5. NET POSITION</b>  |                                     |                                     |
| A. Unexpended Appropriations - Earmarked Funds (Note 23)                  | \$ 9,606,486.21                     | \$ 12,167,789.08                    |
| B. Unexpended Appropriations - Other Funds                                | 527,117,266,103.24                  | 445,520,584,066.46                  |
| C. Cumulative Results of Operations - Earmarked Funds                     | (1,231,732,085,533.51)              | (1,191,056,503,331.19)              |
| D. Cumulative Results of Operations - Other Funds                         | 355,205,362,128.25                  | 342,830,946,584.58                  |
| <b>6. TOTAL NET POSITION</b>  | <hr/> \$ (349,399,850,815.81)       | <hr/> \$ (402,692,804,891.07)       |
| <b>7. TOTAL LIABILITIES AND NET POSITION</b>                              | <hr/> <hr/> \$ 1,642,126,004,200.71 | <hr/> <hr/> \$ 1,481,972,248,635.63 |

Department of Defense  
 Agency Wide  
**CONSOLIDATED STATEMENT OF NET COST**  
 For the periods ended June 30, 2007 and 2006

|   | <b>2007 Consolidated</b>            | <b>2006 Consolidated</b>            |
|---|-------------------------------------|-------------------------------------|
| <b>1. Program Costs</b>                                       |                                     |                                     |
| A. Gross Costs  | \$ 444,487,359,550.54               | \$ 419,357,596,446.52               |
| B. (Less: Earned Revenue)                                     | (35,049,500,334.42)                 | (36,402,615,605.26)                 |
| C. Net Program Costs  | <u>\$ 409,437,859,216.12</u>        | <u>\$ 382,954,980,841.26</u>        |
| <b>2. Cost Not Assigned to Programs</b>                       | 0.00                                | 0.00                                |
| <b>3. (Less: Earned Revenue Not Attributable to Programs)</b> | 0.00                                | 0.00                                |
| <b>4. Net Cost of Operations</b>                              | <u><u>\$ 409,437,859,216.12</u></u> | <u><u>\$ 382,954,980,841.26</u></u> |

Department of Defense

Agency Wide

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended June 30, 2007 and 2006

|  | 2007 Earmarked Funds      | 2007 All Other Funds  |
|--|---------------------------|-----------------------|
| <b>CUMULATIVE RESULTS OF OPERATIONS</b>                        |                           |                       |
| <b>1. Beginning Balances</b>                                   | \$ (1,206,769,332,749.45) | \$ 302,900,988,741.72 |
| <b>2. Prior Period Adjustments:</b>                            |                           |                       |
| 2.A. Changes in accounting principles (+/-)                    | 0.00                      | 0.00                  |
| 2.B. Corrections of errors (+/-)                               | 0.00                      | 0.00                  |
| <b>3. Beginning balances, as adjusted</b>                      | (1,206,769,332,749.45)    | 302,900,988,741.72    |
| <b>4. Budgetary Financing Sources:</b>                         |                           |                       |
| 4.A. Other adjustments (rescissions, etc.)                     | 0.00                      | 0.00                  |
| 4.B. Appropriations used                                       | 1,824,385.13              | 443,130,930,218.21    |
| 4.C. Nonexchange revenue                                       | 2,116,513,073.59          | 201,060,868.19        |
| 4.D. Donations and forfeitures of cash<br>and cash equivalents | 16,250,403.95<br>0.00     | 0.00<br>0.00          |
| 4.E. Transfers-in/out without reimbursement                    | 273,192,992.06            | (118,653,718.90)      |
| 4.F. Other budgetary financing sources                         | 0.00                      | (733,753,753.13)      |
| <b>5. Other Financing Sources:</b>                             |                           |                       |
| 5.A. Donations and forfeitures of property                     | 0.00                      | 3,583,647.26          |
| 5.B. Transfers-in/out without reimbursement (+/-)              | 1,162,449.52              | 4,435,722.12          |
| 5.C. Imputed financing from costs absorbed by others           | 24.32                     | 10,928,833,681.36     |
| 5.D. Other (+/-)   | (15,838,917.61)           | (11,287,024,048.35)   |
| <b>6. Total Financing Sources</b>                              | 2,393,104,410.96          | 442,129,412,616.76    |
| <b>7. Net Cost of Operations (+/-)</b>                         | (37,447,092,557.34)       | 454,627,988,982.59    |
| <b>8. Net Change</b>   | 39,840,196,968.30         | (12,498,576,365.83)   |
| <b>9. Cumulative Results of Operations</b>                     | (1,166,929,135,781.15)    | 290,402,412,375.89    |
| <b>UNEXPENDED APPROPRIATIONS</b>                               |                           |                       |
| <b>10. Beginning Balances</b>                                  | \$ 11,430,871.34          | \$ 313,301,864,412.90 |
| <b>11. Prior Period Adjustments:</b>                           |                           |                       |
| 11.A. Changes in accounting principles                         | 0.00                      | 0.00                  |
| 11.B. Corrections of errors                                    | 0.00                      | 0.00                  |
| <b>12. Beginning balances, as adjusted</b>                     | 11,430,871.34             | 313,301,864,412.90    |
| <b>13. Budgetary Financing Sources:</b>                        |                           |                       |
| 13.A. Appropriations received                                  | 0.00                      | 659,183,817,802.80    |
| 13.B. Appropriations transferred-in/out                        | 0.00                      | 65,635,536.15         |
| 13.C. Other adjustments (rescissions, etc)                     | 0.00                      | (2,303,121,430.40)    |
| 13.D. Appropriations used                                      | (1,824,385.13)            | (443,130,930,218.21)  |
| <b>14. Total Budgetary Financing Sources</b>                   | (1,824,385.13)            | 213,815,401,690.34    |
| <b>15. Unexpended Appropriations</b>                           | 9,606,486.21              | 527,117,266,103.24    |
| <b>16. Net Position</b>  | (1,166,919,529,294.94)    | 817,519,678,479.13    |

Department of Defense

Agency Wide

**CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION**

For the periods ended June 30, 2007 and 2006

|  | 2007 Eliminations | 2007 Consolidated       |
|--|-------------------|-------------------------|
| <b>CUMULATIVE RESULTS OF OPERATIONS</b>              |                   |                         |
| <b>1. Beginning Balances</b>                         | \$ 0.00           | \$ (903,868,344,007.73) |
| <b>2. Prior Period Adjustments:</b>                  |                   |                         |
| 2.A. Changes in accounting principles (+/-)          | 0.00              | 0.00                    |
| 2.B. Corrections of errors (+/-)                     | 0.00              | 0.00                    |
| <b>3. Beginning balances, as adjusted</b>            | 0.00              | (903,868,344,007.73)    |
| <b>4. Budgetary Financing Sources:</b>               |                   |                         |
| 4.A. Other adjustments (rescissions, etc.)           | 0.00              | 0.00                    |
| 4.B. Appropriations used                             | 0.00              | 443,132,754,603.34      |
| 4.C. Nonexchange revenue                             | 0.00              | 2,317,573,941.78        |
| 4.D. Donations and forfeitures of cash               | 0.00              | 16,250,403.95           |
| and cash equivalents                                 | 0.00              | 0.00                    |
| 4.E. Transfers-in/out without reimbursement          | 0.00              | 154,539,273.16          |
| 4.F. Other budgetary financing sources               | 0.00              | (733,753,753.13)        |
| <b>5. Other Financing Sources:</b>                   |                   |                         |
| 5.A. Donations and forfeitures of property           | 0.00              | 3,583,647.26            |
| 5.B. Transfers-in/out without reimbursement (+/-)    | 0.00              | 5,598,171.64            |
| 5.C. Imputed financing from costs absorbed by others | 7,743,037,209.13  | 3,185,796,496.55        |
| 5.D. Other (+/-)                                     | 0.00              | (11,302,862,965.96)     |
| <b>6. Total Financing Sources</b>                    | 7,743,037,209.13  | 436,779,479,818.59      |
| <b>7. Net Cost of Operations (+/-)</b>               | 7,743,037,209.13  | 409,437,859,216.12      |
| <b>8. Net Change</b>                                 | 0.00              | 27,341,620,602.47       |
| <b>9. Cumulative Results of Operations</b>           | 0.00              | (876,526,723,405.26)    |
| <b>UNEXPENDED APPROPRIATIONS</b>                     |                   |                         |
| <b>10. Beginning Balances</b>                        | \$ 0.00           | \$ 313,313,295,284.24   |
| <b>11. Prior Period Adjustments:</b>                 |                   |                         |
| 11.A. Changes in accounting principles               | 0.00              | 0.00                    |
| 11.B. Corrections of errors                          | 0.00              | 0.00                    |
| <b>12. Beginning balances, as adjusted</b>           | 0.00              | 313,313,295,284.24      |
| <b>13. Budgetary Financing Sources:</b>              |                   |                         |
| 13.A. Appropriations received                        | 0.00              | 659,183,817,802.80      |
| 13.B. Appropriations transferred-in/out              | 0.00              | 65,635,536.15           |
| 13.C. Other adjustments (rescissions, etc)           | 0.00              | (2,303,121,430.40)      |
| 13.D. Appropriations used                            | 0.00              | (443,132,754,603.34)    |
| <b>14. Total Budgetary Financing Sources</b>         | 0.00              | 213,813,577,305.21      |
| <b>15. Unexpended Appropriations</b>                 | 0.00              | 527,126,872,589.45      |
| <b>16. Net Position</b>                              | 0.00              | (349,399,850,815.81)    |

Department of Defense

Agency Wide

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended June 30, 2007 and 2006

|  | 2006 Earmarked Funds      | 2006 All Other Funds  |
|--|---------------------------|-----------------------|
| <b>CUMULATIVE RESULTS OF OPERATIONS</b>                        |                           |                       |
| <b>1. Beginning Balances</b>                                   | \$ (1,170,876,050,321.23) | \$ 300,201,835,674.18 |
| <b>2. Prior Period Adjustments:</b>                            |                           |                       |
| 2.A. Changes in accounting principles (+/-)                    | 0.00                      | 0.00                  |
| 2.B. Corrections of errors (+/-)                               | 0.00                      | (21,833,207,720.24)   |
| <b>3. Beginning balances, as adjusted</b>                      | (1,170,876,050,321.23)    | 278,368,627,953.94    |
| <b>4. Budgetary Financing Sources:</b>                         |                           |                       |
| 4.A. Other adjustments (rescissions, etc.)                     | 0.00                      | 0.00                  |
| 4.B. Appropriations used                                       | 1,326,934.16              | 420,843,528,698.96    |
| 4.C. Nonexchange revenue                                       | 2,129,663,779.96          | 23,536,436.73         |
| 4.D. Donations and forfeitures of cash<br>and cash equivalents | 17,663,229.96<br>0.00     | 0.00<br>0.00          |
| 4.E. Transfers-in/out without reimbursement                    | 1,058,213,712.84          | 666,321,027.26        |
| 4.F. Other budgetary financing sources                         | 494,749.45                | (3,861,499,021.45)    |
| <b>5. Other Financing Sources:</b>                             |                           |                       |
| 5.A. Donations and forfeitures of property                     | 0.00                      | 11,609,836.02         |
| 5.B. Transfers-in/out without reimbursement (+/-)              | (130,014,803.32)          | 96,407,140.98         |
| 5.C. Imputed financing from costs absorbed by others           | 16,267.74                 | 3,207,893,120.48      |
| 5.D. Other (+/-)   | (17,621,138.18)           | 3,198,137,767.18      |
| <b>6. Total Financing Sources</b>                              | 3,059,742,732.61          | 424,185,935,006.16    |
| <b>7. Net Cost of Operations (+/-)</b>                         | (38,330,174,968.28)       | 421,293,987,086.37    |
| <b>8. Net Change</b>   | 41,389,917,700.89         | 2,891,947,919.79      |
| <b>9. Cumulative Results of Operations</b>                     | (1,129,486,132,620.34)    | 281,260,575,873.73    |
| <b>UNEXPENDED APPROPRIATIONS</b>                               |                           |                       |
| <b>10. Beginning Balances</b>                                  | \$ 13,394,723.24          | \$ 273,446,877,320.22 |
| <b>11. Prior Period Adjustments:</b>                           |                           |                       |
| 11.A. Changes in accounting principles                         | 0.00                      | 0.00                  |
| 11.B. Corrections of errors                                    | 0.00                      | (527,457.36)          |
| <b>12. Beginning balances, as adjusted</b>                     | 13,394,723.24             | 273,446,349,862.86    |
| <b>13. Budgetary Financing Sources:</b>                        |                           |                       |
| 13.A. Appropriations received                                  | 100,000.00                | 599,799,767,690.22    |
| 13.B. Appropriations transferred-in/out                        | 0.00                      | (111,157,630.00)      |
| 13.C. Other adjustments (rescissions, etc)                     | 0.00                      | (6,770,847,157.66)    |
| 13.D. Appropriations used                                      | (1,326,934.16)            | (420,843,528,698.96)  |
| <b>14. Total Budgetary Financing Sources</b>                   | (1,226,934.16)            | 172,074,234,203.60    |
| <b>15. Unexpended Appropriations</b>                           | 12,167,789.08             | 445,520,584,066.46    |
| <b>16. Net Position</b>  | (1,129,473,964,831.26)    | 726,781,159,940.19    |

Department of Defense

Agency Wide

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended June 30, 2007 and 2006

|  | 2006 Eliminations | 2006 Consolidated       |
|--|-------------------|-------------------------|
| <b>CUMULATIVE RESULTS OF OPERATIONS</b>                        |                   |                         |
| <b>1. Beginning Balances</b>                                   | \$ 0.00           | \$ (870,674,214,647.05) |
| <b>2. Prior Period Adjustments:</b>                            |                   |                         |
| 2.A. Changes in accounting principles (+/-)                    | 0.00              | 0.00                    |
| 2.B. Corrections of errors (+/-)                               | 0.00              | (21,833,207,720.24)     |
| <b>3. Beginning balances, as adjusted</b>                      | 0.00              | (892,507,422,367.29)    |
| <b>4. Budgetary Financing Sources:</b>                         |                   |                         |
| 4.A. Other adjustments (rescissions, etc.)                     | 0.00              | 0.00                    |
| 4.B. Appropriations used                                       | 0.00              | 420,844,855,633.12      |
| 4.C. Nonexchange revenue                                       | 240.00            | 2,153,199,976.69        |
| 4.D. Donations and forfeitures of cash<br>and cash equivalents | 0.00<br>0.00      | 17,663,229.96<br>0.00   |
| 4.E. Transfers-in/out without reimbursement                    | 0.00              | 1,724,534,740.10        |
| 4.F. Other budgetary financing sources                         | 0.00              | (3,861,004,272.00)      |
| <b>5. Other Financing Sources:</b>                             |                   |                         |
| 5.A. Donations and forfeitures of property                     | 0.00              | 11,609,836.02           |
| 5.B. Transfers-in/out without reimbursement (+/-)              | 0.00              | (33,607,662.34)         |
| 5.C. Imputed financing from costs absorbed by others           | 8,831,036.83      | 3,199,078,351.39        |
| 5.D. Other (+/-)   | 0.00              | 3,180,516,629.00        |
| <b>6. Total Financing Sources</b>                              | 8,831,276.83      | 427,236,846,461.94      |
| <b>7. Net Cost of Operations (+/-)</b>                         | 8,831,276.83      | 382,954,980,841.26      |
| <b>8. Net Change</b>   | 0.00              | 44,281,865,620.68       |
| <b>9. Cumulative Results of Operations</b>                     | 0.00              | (848,225,556,746.61)    |
| <b>UNEXPENDED APPROPRIATIONS</b>                               |                   |                         |
| <b>10. Beginning Balances</b>                                  | \$ 0.00           | \$ 273,460,272,043.46   |
| <b>11. Prior Period Adjustments:</b>                           |                   |                         |
| 11.A. Changes in accounting principles                         | 0.00              | 0.00                    |
| 11.B. Corrections of errors                                    | 0.00              | (527,457.36)            |
| <b>12. Beginning balances, as adjusted</b>                     | 0.00              | 273,459,744,586.10      |
| <b>13. Budgetary Financing Sources:</b>                        |                   |                         |
| 13.A. Appropriations received                                  | 0.00              | 599,799,867,690.22      |
| 13.B. Appropriations transferred-in/out                        | 0.00              | (111,157,630.00)        |
| 13.C. Other adjustments (rescissions, etc)                     | 0.00              | (6,770,847,157.66)      |
| 13.D. Appropriations used                                      | 0.00              | (420,844,855,633.12)    |
| <b>14. Total Budgetary Financing Sources</b>                   | 0.00              | 172,073,007,269.44      |
| <b>15. Unexpended Appropriations</b>                           | 0.00              | 445,532,751,855.54      |
| <b>16. Net Position</b>  | 0.00              | (402,692,804,891.07)    |

Department of Defense

Agency Wide

**COMBINED STATEMENT OF BUDGETARY RESOURCES**

For the periods ended June 30, 2007 and 2006

|  | <b>2007 Combined</b>              | <b>2006 Combined</b>              |
|--|-----------------------------------|-----------------------------------|
|  | <hr/>                             | <hr/>                             |
| <b>BUDGETARY FINANCING ACCOUNTS</b>                      |                                   |                                   |
| <b>BUDGETARY RESOURCES:</b>                              |                                   |                                   |
| 1. Unobligated balance, brought forward, October 1       | \$ 85,792,992,172.29              | \$ 68,608,624,657.41              |
| 2. Recoveries of prior year unpaid obligations           | 36,862,605,112.56                 | 21,684,332,850.62                 |
| 3. Budget authority                                      |                                   |                                   |
| 3.A. Appropriation                                       | 745,140,481,735.97                | 681,654,067,406.54                |
| 3.B. Borrowing authority                                 | 0.00                              | 0.00                              |
| 3.C. Contract authority                                  | 84,168,702,766.42                 | 62,151,311,336.96                 |
| 3.D. Spending authority from offsetting collections      |                                   |                                   |
| 3.D.1 Earned   |                                   |                                   |
| 3.D.1.a. Collected                                       | 119,450,601,972.13                | 117,389,612,405.14                |
| 3.D.1.b. Change in receivables from Federal sources      | (2,807,880,610.84)                | 883,750,974.48                    |
| 3.D.2 Change in unfilled customer orders                 |                                   |                                   |
| 3.D.2.a. Advance received                                | 204,060,944.55                    | 120,110,483.92                    |
| 3.D.2.b. Without advance from Federal sources            | 17,481,070,787.18                 | 12,474,863,458.40                 |
| 3.D.3. Anticipated for rest of year, without advances    | 16,628,127,366.91                 | 28,846,231,628.73                 |
| 3.D.4. Previously unavailable                            | 0.00                              | 0.00                              |
| 3.D.5. Expenditure transfers from trust funds            | 0.00                              | 0.00                              |
| 3.E. Subtotal  | <hr/> 980,265,164,962.32          | <hr/> 903,519,947,694.17          |
| 4. Nonexpenditure transfers, net, anticipated and actual | 145,086,536.88                    | (121,379,897.75)                  |
| 5. Temporarily not available pursuant to Public Law      | (43,389,036,582.89)               | (43,089,518,170.54)               |
| 6. Permanently not available                             | (63,813,721,606.69)               | (52,027,463,037.88)               |
| <b>7. Total Budgetary Resources</b>                      | <hr/> <hr/> \$ 995,863,090,594.47 | <hr/> <hr/> \$ 898,574,544,096.03 |

**Department of Defense**  
**Agency Wide**  
**COMBINED STATEMENT OF BUDGETARY RESOURCES**  
**For the periods ended June 30, 2007 and 2006**

|   | <b>2007 Combined</b>                | <b>2006 Combined</b>                |
|---|-------------------------------------|-------------------------------------|
| <b>Status of Budgetary Resources:</b>   |                                     |                                     |
| 8. Obligations incurred:  |                                     |                                     |
| 8.A. Direct   | \$ 540,619,872,491.41               | \$ 493,454,579,309.68               |
| 8.B. Reimbursable   | 113,867,045,177.02                  | 119,687,175,073.56                  |
| 8.C. Subtotal   | <u>654,486,917,668.43</u>           | <u>613,141,754,383.24</u>           |
| 9. Unobligated balance:   |                                     |                                     |
| 9.A. Apportioned  | 301,348,119,165.23                  | 254,939,670,593.70                  |
| 9.B. Exempt from apportionment  | 20,867,860,271.88                   | 2,823,429,538.24                    |
| 9.C. Subtotal   | <u>322,215,979,437.11</u>           | <u>257,763,100,131.94</u>           |
| 10. Unobligated balance not available   | 19,160,193,488.93                   | 27,669,689,580.85                   |
| <b>11. Total status of budgetary resources</b>  | <u><u>\$ 995,863,090,594.47</u></u> | <u><u>\$ 898,574,544,096.03</u></u> |
| <b>Change in Obligated Balance:</b>   |                                     |                                     |
| 12. Obligated balance, net  |                                     |                                     |
| 12.A. Unpaid obligations, brought forward, October 1  | 349,774,559,633.28                  | 302,426,881,241.17                  |
| 12.B. Less: Uncollected customer payments<br>from Federal sources, brought forward, October 1 | <u>\$ (55,414,809,002.65)</u>       | <u>\$ (54,586,765,275.73)</u>       |
| 12.C. Total unpaid obligated balance  | <u>294,359,750,630.63</u>           | <u>247,840,115,965.44</u>           |
| 13. Obligations incurred net (+/-)  | <u>\$ 654,486,917,668.43</u>        | <u>\$ 613,141,754,383.24</u>        |
| 14. Less: Gross outlays   | (617,362,223,027.82)                | (581,967,388,630.53)                |
| 15. Obligated balance transferred, net  |                                     |                                     |
| 15.A. Actual transfers, unpaid obligations (+/-)  | 0.00                                | 0.00                                |
| 15.B. Actual transfers, uncollected customer<br>payments from Federal sources (+/-)           | <u>0.00</u>                         | <u>0.00</u>                         |
| 15.C. Total Unpaid obligated balance transferred, net   | 0.00                                | 0.00                                |
| 16. Less: Recoveries of prior year unpaid obligations, actual                                 | <u>(36,862,605,112.56)</u>          | <u>(21,684,332,850.62)</u>          |
| 17. Change in uncollected customer<br>payments from Federal sources (+/-)                     | (14,673,190,176.34)                 | (13,358,614,432.88)                 |
| 18. Obligated balance, net, end of period   |                                     |                                     |
| 18.A. Unpaid obligations  | 350,036,649,161.33                  | 311,916,914,143.26                  |
| 18.B. Less: Uncollected customer payments (+/-)<br>from Federal sources (-)                   | <u>(70,087,999,178.99)</u>          | <u>(67,945,379,708.61)</u>          |
| 18.C. Total, unpaid obligated balance, net, end of period                                     | <u>279,948,649,982.34</u>           | <u>243,971,534,434.65</u>           |
| <b>Net Outlays</b>  |                                     |                                     |
| <b>19. Net Outlays:</b>   |                                     |                                     |
| 19.A. Gross outlays   | 617,362,223,027.82                  | 581,967,388,630.53                  |
| 19.B. Less: Offsetting collections  | (119,654,662,916.68)                | (117,509,722,889.06)                |
| 19.C. Less: Distributed Offsetting receipts   | <u>(60,455,835,891.41)</u>          | <u>(60,027,864,929.84)</u>          |
| <b>19.D. Net Outlays</b>  | <u><u>\$ 437,251,724,219.73</u></u> | <u><u>\$ 404,429,800,811.63</u></u> |

Department of Defense

Agency Wide

**COMBINED STATEMENT OF BUDGETARY RESOURCES**

For the periods ended June 30, 2007 and 2006

|  | <b>2007 Combined</b>          | <b>2006 Combined</b>          |
|--|-------------------------------|-------------------------------|
|  | <hr/>                         | <hr/>                         |
| <b>NONBUDGETARY FINANCING ACCOUNTS</b>                   |                               |                               |
| <b>BUDGETARY RESOURCES</b>                               |                               |                               |
| 1. Unobligated balance, brought forward, October 1       | \$ 46,834,726.25              | \$ 82,987,971.16              |
| 2. Recoveries of prior year unpaid obligations           | 0.00                          | 0.00                          |
| 3. Budget authority                                      |                               |                               |
| 3.A. Appropriation                                       | 13,107,688.00                 | 0.00                          |
| 3.B. Borrowing authority                                 | 232,922,838.40                | 114,263,107.00                |
| 3.C. Contract authority                                  | 0.00                          | 0.00                          |
| 3.D. Spending authority from offsetting collections      |                               |                               |
| 3.D.1 Earned   |                               |                               |
| 3.D.1.a. Collected                                       | 753,257,660.19                | 879,914,022.20                |
| 3.D.1.b. Change in receivables from Federal sources      | 243,762.75                    | 31,031.25                     |
| 3.D.2 Change in unfilled customer orders                 |                               |                               |
| 3.D.2.a. Advance received                                | 0.00                          | 0.00                          |
| 3.D.2.b. Without advance from Federal sources            | 38,224,064.00                 | (22,970,066.00)               |
| 3.D.3 Anticipated for rest of year, without advances     | 242,037,106.90                | 80,000,236.35                 |
| 3.D.4 Previously unavailable                             | 0.00                          | 0.00                          |
| 3.D.5 Expenditure transfers from trust funds             | 0.00                          | 0.00                          |
| 3.E. Subtotal  | <hr/> 1,279,793,120.24        | <hr/> 1,051,238,330.80        |
| 4. Nonexpenditure transfers, net, anticipated and actual | 0.00                          | 0.00                          |
| 5. Temporarily not available pursuant to Public Law      | 0.00                          | 0.00                          |
| 6. Permanently not available                             | (943,860,443.51)              | (800,242,925.35)              |
| <b>7. Total Budgetary Resources</b>                      | <hr/> <hr/> \$ 382,767,402.98 | <hr/> <hr/> \$ 333,983,376.61 |

**Department of Defense**  
**Agency Wide**  
**COMBINED STATEMENT OF BUDGETARY RESOURCES**  
**For the periods ended June 30, 2007 and 2006**

|   | <b>2007 Combined</b>                   | <b>2006 Combined</b>                   |
|---|--|--|
|   | <hr/>                                  | <hr/>                                  |
| <b>Status of Budgetary Resources:</b>   |  |  |
| 8. Obligations incurred:  |  |  |
| 8.A. Direct   | \$ 340,352,363.38                      | \$ 167,107,235.48                      |
| 8.B. Reimbursable   | 0.00                                   | 0.00                                   |
| 8.C. Subtotal   | <hr/> 340,352,363.38                   | <hr/> 167,107,235.48                   |
| 9. Unobligated balance:   |  |  |
| 9.A. Apportioned  | 14,241,449.96                          | 15,878,773.70                          |
| 9.B. Exempt from apportionment  | 0.00                                   | 0.00                                   |
| 9.C. Subtotal   | <hr/> 14,241,449.96                    | <hr/> 15,878,773.70                    |
| 10. Unobligated balance not available   | 28,173,589.64                          | 150,997,367.43                         |
| <b>11. Total Status of Budgetary Resources</b>  | <hr/> <b>\$ 382,767,402.98</b> <hr/>   | <hr/> <b>\$ 333,983,376.61</b> <hr/>   |
| <b>Change in Obligated Balance:</b>   |  |  |
| 12. Obligated balance, net  |  |  |
| 12.A. Unpaid obligations, brought forward, October 1  | 3,417,765,197.00                       | 3,863,849,780.81                       |
| 12.B. Less: Uncollected customer payments<br>from Federal sources, brought forward, October 1 | <hr/> \$ (76,910,703.00)               | <hr/> \$ (123,710,109.00)              |
| 12.C. Total unpaid obligated balance  | <hr/> 3,340,854,494.00                 | <hr/> 3,740,139,671.81                 |
| 13. Obligations incurred net (+/-)  | \$ 340,352,363.38                      | \$ 167,107,235.48                      |
| 14. Less: Gross outlays   | (363,885,803.57)                       | (402,916,743.83)                       |
| 15. Obligated balance transferred, net  |  |  |
| 15.A. Actual transfers, unpaid obligations (+/-)  | 0.00                                   | 0.00                                   |
| 15.B. Actual transfers, uncollected customer<br>payments from Federal sources (+/-)           | <hr/> 0.00                             | <hr/> 0.00                             |
| 15.C. Total Unpaid obligated balance transferred, net   | <hr/> 0.00                             | <hr/> 0.00                             |
| 16. Less: Recoveries of prior year unpaid obligations, actual                                 | 0.00                                   | 0.00                                   |
| 17. Change in uncollected customer<br>payments from Federal sources (+/-)                     | (38,467,826.75)                        | 22,939,034.75                          |
| 18. Obligated balance, net, end of period   |  |  |
| 18.A. Unpaid obligations  | 3,394,231,756.81                       | 3,628,040,272.46                       |
| 18.B. Less: Uncollected customer payments (+/-)<br>from Federal sources (-)                   | <hr/> (115,378,529.75)                 | <hr/> (100,771,074.25)                 |
| 18.C. Total, unpaid obligated balance, net, end of period                                     | <hr/> 3,278,853,227.06                 | <hr/> 3,527,269,198.21                 |
| <b>Net Outlays</b>  |  |  |
| <b>19. Net Outlays:</b>   |  |  |
| 19.A. Gross outlays   | 363,885,803.57                         | 402,916,743.83                         |
| 19.B. Less: Offsetting collections  | (753,257,660.19)                       | (879,914,022.20)                       |
| 19.C. Less: Distributed Offsetting receipts   | 0.00                                   | 0.00                                   |
| <b>19.D. Net Outlays</b>  | <hr/> <b>\$ (389,371,856.62)</b> <hr/> | <hr/> <b>\$ (476,997,278.37)</b> <hr/> |

Department of Defense

Agency Wide

**CONSOLIDATED STATEMENT OF FINANCING**

For the periods ended June 30, 2007 and 2006

|   | <b>2007 Consolidated</b>     | <b>2006 Consolidated</b>     |
|---|------------------------------|------------------------------|
|   | <hr/>                        | <hr/>                        |
| <b>Resources Used to Finance Activities:</b>  |                              |                              |
| Budgetary Resources Obligated   |                              |                              |
| 1. Obligations incurred   | \$ 654,827,270,031.81        | \$ 613,308,861,618.72        |
| 2. Less: Spending authority from offsetting collections and recoveries (-)                                | (171,982,183,692.52)         | (153,409,645,160.01)         |
| 3. Obligations net of offsetting collections and recoveries   | 482,845,086,339.29           | 459,899,216,458.71           |
| 4. Less: Offsetting receipts (-)  | (60,455,835,891.41)          | (60,027,864,929.84)          |
| 5. Net obligations  | <hr/> 422,389,250,447.88     | <hr/> 399,871,351,528.87     |
| Other Resources   |                              |                              |
| 6. Donations and forfeitures of property  | 3,583,647.26                 | 11,609,836.02                |
| 7. Transfers in/out without reimbursement (+/-)   | 5,598,171.64                 | (33,607,662.34)              |
| 8. Imputed financing from costs absorbed by others  | 3,185,796,496.55             | 3,199,078,351.39             |
| 9. Other (+/-)  | (11,302,862,965.96)          | 3,180,516,629.00             |
| 10. Net other resources used to finance activities  | <hr/> (8,107,884,650.51)     | <hr/> 6,357,597,154.07       |
| <b>11. Total resources used to finance activities</b>   | <hr/> \$ 414,281,365,797.37  | <hr/> \$ 406,228,948,682.94  |
| <b>Resources Used to Finance Items not Part of the Net Cost of Operations</b>                             |                              |                              |
| 12. Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided |                              |                              |
| 12a. Undelivered Orders (-)   | (16,194,254,102.47)          | (10,724,442,071.24)          |
| 12b. Unfilled Customer Orders   | 17,723,355,795.73            | 12,572,003,876.32            |
| 13. Resources that fund expenses recognized in prior periods  | (5,313,870,504.87)           | (2,863,621,083.38)           |
| 14. Budgetary offsetting collections and receipts that do not affect net cost of operations               | 1,863,797,633.27             | 4,311,471,289.41             |
| 15. Resources that finance the acquisition of assets  | (64,090,192,416.11)          | (73,691,026,775.77)          |
| 16. Other resources or adjustments to net obligated resources that do not affect net cost of operations   |                              |                              |
| 16a. Less: Trust or Special Fund Receipts Related to exchange in the Entity's Budget (-)                  | (10,000,000.00)              | (10,000,000.00)              |
| 16b. Other (+/-)  | 11,293,681,147.06            | (3,159,118,251.04)           |
| <b>17. Total resources used to finance items not part of the net cost of operations</b>                   | <hr/> \$ (54,727,482,447.39) | <hr/> \$ (73,564,733,015.70) |
| <b>18. Total resources used to finance the net cost of operations</b>                                     | <hr/> \$ 359,553,883,349.98  | <hr/> \$ 332,664,215,667.24  |

Department of Defense

Agency Wide

**CONSOLIDATED STATEMENT OF FINANCING**

For the periods ended June 30, 2007 and 2006

|   | <b>2007 Consolidated</b>          | <b>2006 Consolidated</b>          |
|---|-----------------------------------|-----------------------------------|
|   | <hr/>                             | <hr/>                             |
| <b>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:</b>      |                                   |                                   |
| Components Requiring or Generating Resources in Future Period:  |                                   |                                   |
| 19. Increase in annual leave liability  | 1,842,755,868.73                  | 588,250,295.59                    |
| 20. Increase in environmental and disposal liability  | 2,755,316,754.58                  | 7,406,237,030.00                  |
| 21. Upward/Downward reestimates of credit subsidy expense (+/-)   | (5,804,108.06)                    | (33,786,016.31)                   |
| 22. Increase in exchange revenue receivable from the public (-)   | (34,668,999.55)                   | (39,219,306.82)                   |
| 23. Other (+/-)   | 4,210,451,488.58                  | 348,503,415.61                    |
| 24. Total components of Net Cost of Operations that will require or generate resources in future periods                | <hr/> 8,768,051,004.28            | <hr/> 8,269,985,418.07            |
| Components not Requiring or Generating Resources:   |                                   |                                   |
| 25. Depreciation and amortization   | 22,147,190,692.17                 | 24,983,669,109.49                 |
| 26. Revaluation of assets or liabilities (+/-)  | 4,111,237,822.33                  | 4,152,395,475.73                  |
| 27. Other (+/-)   |                                   |                                   |
| 27a. Trust Fund Exchange Revenue  | (18,374,958,334.93)               | (19,743,062,734.79)               |
| 27b. Cost of Goods Sold   | 40,403,907,125.63                 | 35,428,743,817.43                 |
| 27c. Operating Material & Supplies Used   | 19,823,180,004.41                 | 3,779,062,660.20                  |
| 27d. Other  | (26,994,632,447.75)               | (6,580,028,572.11)                |
| 28. Total components of Net Cost of Operations that will not require or generate resources                              | <hr/> 41,115,924,861.86           | <hr/> 42,020,779,755.95           |
| <b>29. Total components of net cost of operations that will not require or generate resources in the current period</b> | <hr/> \$ 49,883,975,866.14        | <hr/> \$ 50,290,765,174.02        |
| <b>30. Net Cost of Operations</b>   | <hr/> <hr/> \$ 409,437,859,216.12 | <hr/> <hr/> \$ 382,954,980,841.26 |

Department of Defense

Agency Wide

**COMBINED STATEMENT OF CUSTODIAL ACTIVITY**

For the periods ended June 30, 2007 and 2006

|   | <b>2007 Combined</b> | <b>2006 Combined</b>       |
|---|----------------------|----------------------------|
| <b>1.SOURCE OF COLLECTIONS</b>  |                      |                            |
| A. Deposits by Foreign Governments  | \$ 0.00              | \$ 9,664,453,325.26        |
| B. Seized Iraqi Cash  | 0.00                 | 0.00                       |
| C. Other Collections  | 0.00                 | 0.00                       |
| D. Total Cash Collections   | <u>\$ 0.00</u>       | <u>\$ 9,664,453,325.26</u> |
| E. Accrual Adjustments (+/-)  | \$ 0.00              | \$ 0.00                    |
| F. Total Custodial Collections  | <u>\$ 0.00</u>       | <u>\$ 9,664,453,325.26</u> |
| <b>2.DISPOSITION OF COLLECTIONS</b>   |                      |                            |
| A. Disbursed on Behalf of Foreign Governments and International Organizations | \$ 5,693,215.12      | \$ 8,975,307,033.80        |
| B. Seized Assets Disbursed on behalf of Iraqi People                          | 1,797,292.28         | 25,471,113.08              |
| C. Increase (Decrease) in Amounts to be Transferred                           | (5,693,215.12)       | 689,146,291.46             |
| D. Collections Used for Refunds and Other Payments                            | 0.00                 | 0.00                       |
| E. Retained by The Reporting Entity   | 0.00                 | 0.00                       |
| F. Seized Assets Retained for Support of the Iraqi People                     | (1,797,292.28)       | (25,471,113.08)            |
| G. Total Disposition of Collections   | <u>\$ 0.00</u>       | <u>\$ 9,664,453,325.26</u> |
| <b>3. NET CUSTODIAL COLLECTION ACTIVITY</b>                                   | <u>\$ 0.00</u>       | <u>\$ 0.00</u>             |

# 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 (CFO) Act of 1990,” expanded by the “Government Management Reform Act (GMRA) of 1994,” and other appropriate legislation. The financial statements have been prepared from the books and records of the Department in accordance with the “DoD Financial Management Regulation,” the Office of Management and Budget (OMB) Circular No. A-136, “Financial Reporting Requirements,” and to the extent possible generally accepted accounting principles (GAAP). Effective 4<sup>th</sup> Quarter, (Fiscal Year) FY 2006, the Department no longer publishes consolidating/combining financial statements. The accompanying financial statements account for all resources for which the Department is responsible unless otherwise noted. Information relative to classified assets, programs, and operations is excluded from the statements or otherwise aggregated and reported in such a manner that it is not discernable.

The Department is unable to fully implement all elements of GAAP and OMB Circular No. A-136 due to limitations of its financial management processes and systems, and nonfinancial systems and processes that feed into the financial statements. The Department derives its reported values and information for major asset and liability categories largely from nonfinancial systems, such as inventory and logistics systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with GAAP. The Department continues to implement process and system improvements addressing these limitations. The Department currently has 12 auditor identified material weaknesses: (1) Financial Management Systems, (2) Intragovernmental Eliminations, (3) Unsupported Accounting Entries, (4) Fund Balance with Treasury, (5) Environmental Liabilities, (6) General Property, Plant and Equipment (PP&E), (7) Government Property and Material in Possession of Contractors, (8) Inventory, (9) Operating Materials and Supplies (OM&S), (10) Statement of Net Cost, (11) Statement of Financing, and (12) Accounts Payable.

## 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. Auditors are required to audit the financial statements of the following stand-alone Department reporting activities: (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).

The Department requires the Marine Corps General and Working Capital Funds and the following Defense Agencies to prepare internal stand-alone auditable financial statements: (1) Defense Logistics Agency, (2) Defense Finance and Accounting Service, (3) Defense Information Systems Agency, (4) Defense Contract Audit Agency, (5) Defense Commissary Agency, (6) Defense Security Service, (7) Defense Threat Reduction Agency, (8) Defense Advanced Research Projects Agency, (9) Chemical and Biological Defense Program, (10) Missile Defense Agency, (11) Services Medical Activity, (12) TRICARE Management Activity, (13) U.S. Special Operations Command, and (14) Defense Security Cooperative Agency.

## 1.C. Appropriations and Funds

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

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

Working capital funds (WCF) received funding to establish an initial corpus through an appropriation or a transfer of resources from existing appropriations or funds. The corpus finances operations and transactions that flow through the fund. The WCF resources the goods and services sold to customers on a reimbursable basis and maintains the corpus. Reimbursable receipts fund future operations and generally are available in their entirety for use without further congressional action. At various times, Congress provides additional appropriations to supplement the WCF as an infusion of cash when revenues are inadequate to cover costs within the corpus.

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. Certain trust and special funds may be designated as earmarked funds. Earmarked funds are financed by specifically identified revenues, required by statute to be used for designated activities, benefits or purposes, and remain available over time. Earmarked funds also have a requirement to account for and report on the receipt, use and retention of revenues and other financing sources that distinguish them from general revenues.

Special fund accounts are used to record government receipts reserved for a specific purpose.

Deposit funds are used to record amounts held temporarily until paid to the appropriate government or public entity. The Department is acting as an agent or a custodian for funds awaiting distribution.

The Department is a party to allocation transfers with other federal agencies as a transferring (parent) entity and/or a receiving (child) entity. Allocation transfers are legal delegations by one agency of its authority to obligate budget authority and outlay funds for another agency. Generally, all financial activity related to these allocation transfers (e.g. budget authority, obligations, outlays) is reported in the financial statements of the parent entity. Exceptions to this general rule apply to specific funds for which OMB has directed that all activity be reported in the financial statements of the child entity. Exceptions include U.S. Treasury-Managed Trust Funds, Executive Office of the President (EOP), and other funds specifically designated by OMB.

The Department is a party to allocation transfers as the child for the following agencies: Departments of Agriculture, Interior, Energy, and Transportation; the Appalachian Regional Commission; Foreign Military Financing Program; International Military Education and Training Program; and Federal Highway Administration.

Additionally, certain federal activities are exempt by OMB from reporting allocation transfers as the parent. The exceptions reported by the Department include South Dakota Terrestrial Wildlife Habitat Restoration, Inland Waterways and Harbor Maintenance, and the EOP.

The Department allocates funds, as the parent, to the Departments of Transportation and Agriculture and reports related activity in its financial statements.

#### **1.D. Basis of Accounting**

For FY 2007, 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. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP. Most of the Department's (financial and nonfinancial) legacy systems were designed to record information on a budgetary basis.

The Department has undertaken efforts to determine the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with GAAP. One such action is the current revision of its accounting systems to record transactions based on the U. S. 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 Department's financial data will be based on budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and adjustments for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities.

In addition, the Department identifies program costs based upon the major appropriation groups provided by the Congress. Current processes and systems do not capture and report accumulated costs for major programs based upon the performance measures as required by the Government Performance and Results Act. 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 Standard (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government".

### **1.E. Revenues and Other Financing Sources**

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

Depot Maintenance and Ordnance WCF activities recognize revenue according to the percentage of completion method. Supply Management WCF activities recognize revenue from the sale of inventory items.

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

### **1.F. Recognition of Expenses**

For financial reporting purposes, the Department's 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 OM&S, operating expenses are generally recognized when the items are purchased. Efforts are underway to transition to the consumption method for recognizing OM&S expenses.

### **1.G. Accounting for Intragovernmental Activities**

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within the Department or between two or more federal agencies. However, the Department cannot accurately eliminate intragovernmental transactions by customer because the Department's systems do not track at the transaction level. Generally, seller entities within the Department provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal Department accounting offices. In most cases, the buyer-side records are adjusted to agree with the Department's seller-side balances. IntraDoD governmental balances are then eliminated. The volume of

intragovernmental transactions is so large that after-the-fact reconciliations cannot be accomplished effectively with existing or foreseeable resources. The Department is developing long-term system improvements to ensure accurate intragovernmental information, to include sufficient up-front edits and controls eliminating the need for after-the-fact reconciliations.

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

The Department’s proportionate share of public debt and related expenses of the Federal Government is not included. The Federal Government does not apportion debt and its related costs to federal agencies. The Department’s financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues. Financing for the construction of the Department’s 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 U.S. Treasury does not allocate such costs to the Department.

#### **1.H. Transactions with Foreign Governments and International Organizations**

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

Beginning in FY 2007, the Department reports in its basic financial statements the Foreign Military Sales Program executed on behalf of the Executive Office of the President. This program was previously reported as "Other Accompanying Information."

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

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

In addition, DFAS sites and USACE Finance Center submit reports to the U.S. Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The U.S. Treasury records this information to the applicable Fund Balance with Treasury (FBWT) account. Differences between the Department’s recorded balance in FBWT accounts and U.S. 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, which includes coin, paper currency, negotiable instruments, and amounts held for deposit in banks and other financial institutions. Foreign currency consists of the total U.S. dollar equivalent of both purchased and nonpurchased foreign currencies held in foreign currency fund accounts.

The majority of cash and all foreign currency is classified as nonentity and is restricted. Amounts reported consist primarily of cash and foreign currency held by disbursing officers to carry out their paying, collecting, and foreign currency accommodation exchange missions. Cash seized during Operation Iraqi Freedom is restricted for use to assist the Iraqi people and support the restoration 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 current at the date of payment and a budget rate established at the beginning of each fiscal year. Foreign currency fluctuations related to other appropriations require adjustments to the original obligation amount at the time of payment. The Department does not separately identify foreign currency fluctuation transactions.

### **1.K. Accounts Receivable**

As presented in the Balance Sheet, accounts receivable includes three categories: accounts receivable, 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 in accordance with dispute resolution procedures defined in the Intragovernmental Business Rules published in the Treasury Financial Manual at <http://www.fms.treas.gov/tfm/vol1/07-03.pdf>.

### **1.L. Direct Loans and Loan Guarantees**

The Department operates a direct loan and loan guarantee program authorized by the National Defense Authorization Act for FY 1996, Public Law 104-106, 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.

The National Defense Authorization Act for FY 2005, Public Law 108-375, Section 2805 provided permanent authorities to the Military Housing Privatization Initiative.

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

The Department administers the Foreign Military Financing program on behalf of Executive Office of the President. This program is authorized by sections 23 and 24 of the Arms Export Control Act (P.L. 90-629), as amended, and section 503(a). This program provides loans to help countries purchase U.S. produced weapons, defense equipment, services, or military training. The direct loans and loan guarantees related to Foreign Military Sales are included in the basic financial statements.

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**

The Department values approximately 64% of its resale inventory using the moving average cost method. An additional 8% (fuel inventory) is reported using the first-in-first-out method. The Department reports the remaining 28% of resale inventories 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 Department is continuing to transition the balance of the inventories to the moving average cost method. However, since the on-hand balances which were transitioned were not, for the most part, baselined to auditable historical cost, the reported values remain noncompliant with SFFAS No. 3 and GAAP.

The Department manages only military or government-specific materiel under normal conditions. Materiel is a unique term that relates to military force management, and includes all items (including ships, tanks, self-propelled weapons, aircraft, etc., and related spares, repair parts, and support equipment, but excluding real property, installations, and utilities) necessary to equip, operate, maintain, and support military activities without distinction as to its application for administrative or combat purposes. Items commonly used in and available from the commercial sector are not managed in the Department's 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. The Department holds materiel based on military need and support for contingencies. 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, unless otherwise noted.

Related property includes OM&S and stockpile materials. The OM&S, including munitions not held for sale, are valued at standard purchase price. The Department uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored, such as ammunition and engines, are generally recorded using the consumption method and are reported on the Balance Sheet as OM&S. When current systems cannot fully support the consumption method, the Department uses the purchase method. Under this method, materials and supplies are expensed when purchased. During FY 2007, the Department expensed significant amounts using the purchase method because the systems could not support the consumption method or management deemed that the item was in the hands of the end user. This is a material weakness for the Department and long-term system corrections are in process. Once the proper systems are in place, these items will be accounted for under the consumption method of accounting.

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

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

Past audits identified uncertainties about the completeness and existence of the reported values of inventory. Inventory available and purchased for resale includes consumable spare and repair parts and repairable items owned and managed by the Department. This inventory is retained to support military or national contingencies. Inventory held for repair is damaged inventory that requires repair to make suitable for sale. Often, it is more economical to repair these inventory items rather than to procure these items. The Department often relies on weapon systems and machinery no longer in production. As a result, 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. 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 that are yet to be placed in service and transferred to an asset account. The work in process designation may also be used to accumulate the amount paid to a contractor under cost reimbursable contracts, to include amounts withheld from payment to ensure performance and amounts paid to other government plants for accrued costs of end items of material 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**

The Department reports investments in U.S. Treasury securities at cost, net of amortized premiums or discounts. Premiums or discounts are amortized 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 nonmarketable securities. The two types of nonmarketable securities are par value and market-based intragovernmental securities. The Bureau of Public Debt issues nonmarketable par value intragovernmental securities. Nonmarketable, market-based intragovernmental securities mimic marketable securities, but are not publicly traded.

The Department's net investments are held by various trust and special funds. These funds include the Military Retirement Trust Fund; Medicare-Eligible Retiree Health Care Fund; Other Defense Organizations General Fund trust and special funds; donations (Gift Funds); and the USACE South Dakota Terrestrial Habitat Restoration, Inland Waterways, and Harbor Maintenance Trust Fund accounts.

Other investments represent limited partnerships, entered into on behalf of the U.S. Government in support of the Military Housing Privatization Initiative authorized by Public Law 104-106, Section 2801. These investments do not require market value disclosure.

### **1.O. General Property, Plant and Equipment**

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

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

In FY 2006, the Department revised the real property capitalization threshold from \$100 thousand to \$20 thousand. The current \$100 thousand capitalization threshold remains unchanged for the remaining General PP&E categories. Not all military departments have implemented this revised policy due to system and process limitations. General PP&E assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of two or more years and the acquisition cost equals or exceeds the Department's capitalization threshold of \$100 thousand. The Department also requires capitalization of improvement costs over the Department's capitalization threshold of \$100 thousand 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 thousand, \$25 thousand, and \$50 thousand for FYs 1993, 1994, and 1995, respectively, and an estimated useful life of two or more years. General PP&E previously capitalized at amounts below \$100 thousand was written off of General Fund financial statements in FY 1998. No adjustment was made for WCF assets that remain capitalized and reported on WCF financial statements. For WCF activities, all General PP&E used in the performance of their mission is categorized as General PP&E, whether or not it meets the definition of any other General PP&E categories.

The USACE Civil Works General PP&E is capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of two or more years and the acquisition cost exceeds \$25 thousand. One exception is that all buildings and structures related to hydropower projects are capitalized regardless of cost. Prior to FY 2004, the Corps capitalized *all* buildings and structures regardless of cost. In FY 2003, the Corps increased the threshold (effective FY 2004) for buildings and structures to \$25 thousand for all Civil Works appropriations with the exception of Revolving Fund and Power Marketing Agency assets and expensed all previously acquired assets that did not meet the new \$25 thousand threshold.

When it is in the best interest of the government, the Department provides government property 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 Department capitalization threshold, Federal accounting standards require that it be reported on the Department's Balance Sheet.

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

### **1.P. Advances and Prepayments**

The Department's policy is to record advances and prepayments in accordance with GAAP. As such, payments made in advance of the receipt of goods and services are reported as an asset on the Balance Sheet. The Department's policy is to expense and/or properly classify assets when the related goods and services are received. Not all DoD entities have implemented this policy primarily due to system limitations.

### **1.Q. Leases**

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

Office space and leases entered into by the Department in support of contingency operations are the largest component of operating leases. These costs were gathered from existing leases, General Services Administration (GSA) bills, and Interservice Support Agreements. Future year projections use the Consumer Price Index (CPI) rather than the Departmental 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**

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

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 may provide financing payments. Contract financing payments are defined in the Federal Acquisition Regulations, Part 32, as authorized disbursements of monies to a contractor prior to acceptance of supplies or services by the Government. Contract financing payment clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advance and interim payments, progress payments based on cost, and interim payments under certain cost-reimbursement contracts.

Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion, which the Defense Federal Acquisitions Regulations Supplement authorizes only for construction of real property, shipbuilding, and ship conversion, alteration, or repair. Progress payments for real property and ships are reported as Construction in Progress. It is DoD policy to record certain contract financing payments as Other Assets.

### **1.S. Contingencies and Other Liabilities**

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

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. Examples of loss contingencies include the collectibility of receivables, pending, or threatened litigation, and possible claims and assessments. The Department's risk of loss and resultant contingent liabilities arise from pending or threatened litigation or claims and assessments 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 military equipment nuclear-powered assets when placed into service. Such amounts are developed in conjunction with, and not easily identifiable from, environmental disposal costs.

### **1.T. Accrued Leave**

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

### **1.U. Net Position**

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

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

Cumulative Results of Operations represent the net difference, since inception of an activity, between expenses and losses and financing sources (including appropriations, revenue, and gains). Beginning with FY 1998, the cumulative results also include donations and transfers in and out of assets that were not reimbursed.

### **1.V. Treaties for Use of Foreign Bases**

The Department has the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. The Department purchases capital assets overseas with appropriated funds; however, the host country retains title to the land and capital improvements. Generally, treaty terms allow the Department continued use of these properties until the treaties expire. In the event treaties or other agreements are terminated, whereby use of the foreign bases is prohibited, losses are recorded for the value of any nonretrievable capital assets. The settlement due to the U.S. or host nation is negotiated and takes into account the value of capital investments and may be offset by the cost of environmental cleanup.

### **1.W. Comparative Data**

Not Applicable.

### **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, unless title passes.

### **1.Y. Undistributed Disbursements and Collection**

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

The Department's policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements are recorded in accounts payable. Unsupported undistributed collections are recorded in other liabilities.

## **1.Z. Significant Events**

Beginning in FY 2007, the Office of Management and Budget changed the reporting requirements for allocation transfers. Due to this change the Department reports in its basic financial statements the programs it administers on behalf of the Executive Office of the President including the Foreign Military Sales Program. Previously, the Department recorded the programs as “Other Accompanying Information,” rather than as part of the basic financial statements.

|                |                         |
|----------------|-------------------------|
| <b>Note 2.</b> | <b>Nonentity Assets</b> |
|----------------|-------------------------|

| As of June 30                      | 2007                    | 2006                    |
|------------------------------------|-------------------------|-------------------------|
| <b>1. Intragovernmental Assets</b> |                         |                         |
| A. Fund Balance with Treasury      | \$ 10,598,252,712.45    | \$ 2,987,418,621.76     |
| B. Accounts Receivable             | 117,919.97              | 316,338.60              |
| C. Total Intragovernmental Assets  | \$ 10,598,370,632.42    | \$ 2,987,734,960.36     |
| <b>2. Nonfederal Assets</b>        |                         |                         |
| A. Cash and Other Monetary Assets  | \$ 14,771,186,572.34    | \$ 1,919,125,168.05     |
| B. Accounts Receivable             | 5,728,042,386.26        | 5,490,521,495.54        |
| C. Other Assets                    | 10,741,125,039.87       | 203,827,243.50          |
| D. Total Nonfederal Assets         | \$ 31,240,353,998.47    | \$ 7,613,473,907.09     |
| <b>3. Total Nonentity Assets</b>   | \$ 41,838,724,630.89    | \$ 10,601,208,867.45    |
| <b>4. Total Entity Assets</b>      | \$ 1,600,287,279,569.82 | \$ 1,471,371,039,768.18 |
| <b>5. Total Assets</b>             | \$ 1,642,126,004,200.70 | \$ 1,481,972,248,635.60 |

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

Intragovernmental Fund Balance with Treasury is primarily comprised of Foreign Military Sales Trust Funds (FMSTF) advance deposits. The FMSTF facilitates the purchases of U.S. Defense articles and services by foreign countries and receives funds in advance from foreign customers based on future requirement forecasts. This balance also includes deposit funds, and unexpended seized Iraqi cash and the Development Funds for Iraq.

Nonfederal Cash and Other Monetary Assets consist of (1) cash received from foreign governments deposited in the Federal Reserve Bank, and (2) Treasury cash deposited in U.S. commercial banks, foreign banks, or held by Disbursing Officers to carry out payment, collection, and foreign currency accommodation exchange missions. Foreign currency is valued using the U.S. Treasury prevailing rate of exchange.

Nonfederal Accounts Receivable consist of amounts due for cancelled year appropriations, interest receivable on aged debt, and fines and penalties due to delinquency on a debt. Proceeds are returned to the U.S. Treasury. There are certain entity accounts receivable associated with cancelled year accounts that once collected the Department has specific statutory authority to retain and remain as entity assets.

Nonfederal Other Assets primarily consist of FMSTF advances paid to contractors for the purchase of U.S. Defense articles and services by foreign customers.

|                |                                   |
|----------------|-----------------------------------|
| <b>Note 3.</b> | <b>Fund Balance with Treasury</b> |
|----------------|-----------------------------------|

| As of June 30                                      | 2007                   | 2006                  |
|--|------------------------|-----------------------|
| <b>1. Fund Balances</b>                            |                        |                       |
| A. Appropriated Funds                              | \$ 521,873,253,923.40  | \$ 446,228,554,949.39 |
| B. Revolving Funds                                 | 10,520,689,122.79      | 8,144,889,637.71      |
| C. Trust Funds                                     | 9,923,594,411.68       | 1,654,624,529.54      |
| D. Special Funds                                   | 275,765,585.53         | 271,430,769.75        |
| E. Other Fund Types                                | 3,620,513,842.96       | 3,434,470,476.62      |
| F. Total Fund Balances                             | \$ 546,213,816,886.36  | \$ 459,733,970,363.01 |
| <b>2. Fund Balances Per Treasury Versus Agency</b> |                        |                       |
| A. Fund Balance per Treasury                       | \$ 534,354,197,897.40  | \$ 456,827,519,829.03 |
| B. Fund Balance per Agency                         | 546,213,816,886.36     | 459,733,970,363.01    |
| <b>3. Reconciling Amount</b>                       |                        |                       |
|  | \$ (11,859,618,988.96) | \$ (2,906,450,533.98) |

Other Fund Types primarily consist of deposit funds, receipt accounts, clearing accounts, seized Iraqi cash, Development Fund for Iraq, and Foreign Military Sales Trust Funds (FMSTF) advance deposits.

The Department shows a reconciling net difference of \$11.9 billion with U.S Treasury as of 3<sup>rd</sup> Quarter, FY 2007. This is primarily due to the reporting of parent/child allocation transfers in accordance with the Office of Management and Budget (OMB) Circulars A-136, "Financial Reporting Requirements" and A-11, "Preparation, Submission and Execution of the Budget."

As the parent, the Department allows the Department of Transportation (DOT) and U.S Department of Agriculture (USDA) to execute certain missions on its behalf. The Department reports Fund Balance with Treasury (FBWT) in its Balance Sheet, and the U.S. Treasury reports the funding in the child's Fund Balance per Agency (Line 2B).

As the child, the Department executes on the behalf of USDA, DOT, Department of Interior, Department of Energy, Federal Highway Administration and Appalachian Regional Commission. The Department does not include this asset in its Balance Sheet, but is included in FBWT per Treasury (Line 2A).

As an exception, OMB Circular A-136 requires the child to report for the Executive Office of the President and Treasury-Managed Accounts (Inland Waterways and Harbor Maintenance). The Department includes these assets on its Balance Sheet. The Treasury reports these amounts in the Governmentwide accounting system as belonging to EOP and Treasury-Managed Accounts; however, per OMB, the Department reflects these amounts in its own FBWT.

|   |
|---|
| <b>Status of Fund Balance with Treasury</b> |
|---|

| As of June 30                                 | 2007                    | 2006                    |
|---|-------------------------|-------------------------|
| <b>1. Unobligated Balance</b>                 |                         |                         |
| A. Available                                  | \$ 302,410,399,120.50   | \$ 240,291,391,571.83   |
| B. Unavailable                                | 351,634,471,825.06      | 312,564,566,980.98      |
| <b>2. Obligated Balance not yet Disbursed</b> | \$ 353,430,880,918.14   | \$ 315,544,954,415.72   |
| <b>3. Nonbudgetary FBWT</b>                   | \$ 5,747,051,669.82     | \$ (1,428,153,829.05)   |
| <b>4. NonFBWT Budgetary Accounts</b>          | \$ (467,008,986,647.16) | \$ (416,904,808,476.23) |
| <b>5. Total</b>                               | \$ 546,213,816,886.36   | \$ 450,067,950,663.25   |

The Status of Fund Balance with Treasury (FBWT) reflects the budgetary resources to support the FBWT.

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

Obligated balance not yet disbursed represents funds that have been obligated for goods that have not been received, services that have not been performed, and goods and services that have been delivered/received but not yet paid.

Nonbudgetary FBWT includes entity and nonentity FBWT accounts which represent adjustments that do not have budgetary authority, such as unavailable receipt accounts or clearing accounts. Nonbudgetary FBWT consists of balances of deposit funds, receipt accounts, clearing accounts, seized Iraqi cash, Development Fund for Iraq, and FMSTF advance deposits.

NonFBWT Budgetary Accounts represent adjustments to budgetary accounts that do not affect FBWT. NonFBWT Budgetary Accounts consists of trust fund investments in U.S. Treasury securities, unfilled customer orders without advance, contract and borrowing authority, reimbursements receivable, and interest receivable. This category reduces the Status of FBWT.

Certain unobligated balances are restricted for future use and are not apportioned for current use. Unobligated balances for trust fund accounts are restricted for use by the Public Law that established the funds. The Department is the lead agency for reporting the financial data for certain trust funds such as the Inland Waterways, Harbor Maintenance, and South Dakota Terrestrial Wildlife Habitat Restoration. The U. S. Treasury, Bureau of the Public Debt (BPD) maintains the investments and the investment accounting records for these funds and invests the trust fund receipts. The BPD transfers funds to the individual trust funds as funds are needed.

|   |
|---|
| <b>Disclosures Related to Suspense/Budget Clearing Accounts</b> |
|---|

| As of June 30   | 2005                       | 2006                     | 2007                     | (Decrease)/<br>Increase from FY<br>2006 - 2007 |
|---|----------------------------|--------------------------|--------------------------|--|
| <b>Account</b>  |                            |                          |                          |  |
| F3845 – Personal Property Proceeds                      | \$ 1,941,542.73            | \$ 542,577.31            | \$ 733,571.10            | 190,993.79                                     |
| F3875 – Disbursing Officer Suspense                     | 181,791,781.39             | 918,943,032.45           | 486,538,170.21           | (432,404,862.24)                               |
| F3880 – Lost or Cancelled Treasury Checks               | 14,553,424.41              | 14,142,439.01            | 15,545,569.92            | 1,403,130.91                                   |
| F3882 – Uniformed Services Thrift Savings Plan Suspense | 89,911,734.76              | 109,783,743.24           | 119,687,301.43           | 9,903,558.19                                   |
| F3885 – Interfund/IPAC Suspense                         | (508,570,219.37)           | (191,545,520.18)         | (249,045,504.60)         | (57,499,984.42)                                |
| F3886 – Thrift Savings Plan Suspense                    | (109,967,095.95)           | 1,891,752.42             | (11,882,523.99)          | (13,774,276.41)                                |
| <b>Total</b>  | <b>\$ (330,338,832.03)</b> | <b>\$ 853,758,024.25</b> | <b>\$ 361,576,584.07</b> | <b>(492,181,440.18)</b>                        |

**Abnormal Balances**

The \$11.9 million credit balance for F3886, Thrift Savings Plan Suspense (TSP), represents negative adjustments, lost earnings, forfeitures, and loan repayments.

**Other Disclosures**

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

The F3875 suspense clearing represents the Disbursing Officer's suspense. Account F3885, represents the Interfund and Intragovernmental Payment and Collection suspense. Account F3886 represents the (payroll) TSP suspense. These three suspense accounts temporarily hold collections or disbursements until they can be assigned or identified to a valid appropriation.

The F3880 suspense account represents the balance of U.S. 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 U.S. Treasury and need to be transferred to the original appropriation.

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

The total amounts reported above for FY 2005 and FY 2006 do not agree with balances reported last year-end due to the inclusion of the Personal Property Proceeds account in the current year schedule. The note schedule did not include this account for 3<sup>rd</sup> Quarter, FY 2006. In addition, the amounts reported in FY 2005 have been changed to reflect correct balances reported in the prior year. Due to timing issues in receipt of expenditure information in prior years, the Department corrected prior year balances to better reflect year-end reporting.

|   |
|---|
| <b>Disclosures Related to Problem Disbursements</b> |
|---|

| As of June 30   | 2005                        | 2006                        | 2007                        | (Decrease)/<br>Increase from FY<br>2006 to 2007 |
|---|-----------------------------|-----------------------------|-----------------------------|---|
| <b>1. Total Problem Disbursements, Absolute Value</b> |                             |                             |                             |   |
| A. Unmatched Disbursements (UMDs)                     | \$ 4,099,709,326.87         | \$ 2,485,453,228.96         | \$ 1,841,536,892.44         | (643,916,336.52)                                |
| B. Negative Unliquidated Obligations (NULO)           | 305,066,208.80              | 209,186,910.35              | 122,235,794.31              | (86,951,116.04)                                 |
| C. In-Transit Disbursements                           | 9,839,352,564.00            | 8,049,962,051.00            | 8,285,759,344.89            | 235,797,293.89                                  |
| <b>Total</b>  | <b>\$ 14,244,128,099.67</b> | <b>\$ 10,744,602,190.31</b> | <b>\$ 10,249,532,031.64</b> | <b>(495,070,158.67)</b>                         |

Problem Disbursements are reported as an absolute value amount. Absolute value is the sum of the positive values of debit and credit transactions without regard to the plus or minus signs.

An Unmatched Disbursement occurs when a payment is not matched to a corresponding obligation in the accounting system.

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

The In-transits represent the absolute value of disbursements and collections made by a Department disbursing activity on behalf of an accountable activity and have not been posted to the accounting system. Beginning with 2<sup>nd</sup> Quarter FY, 2007, in-transit disbursements are reported as an absolute value as opposed to the net amounts disclosed in prior years. This reporting change applies to amounts in the note schedule for both the current and comparative years.

The amounts reported in FY 2005 and FY 2006 have been changed to reflect correct balances reported in the prior year problem disbursements. Due to timing issues in receipt of expenditure information in prior years, the Department corrected prior year balances to better reflect year-end reporting.

|                |   |
|----------------|---|
| <b>Note 4.</b> | <b>Investments and Related Interest</b> |
|----------------|---|

| As of June 30                                 | 2007                  |                     |                                |                       |                         |
|---|-----------------------|---------------------|--------------------------------|-----------------------|-------------------------|
|   | Cost                  | Amortization Method | Amortized (Premium) / Discount | Investments, Net      | Market Value Disclosure |
| <b>1. Intragovernmental Securities</b>        |                       |                     |                                |                       |                         |
| <b>A. Nonmarketable, Market-Based</b>         |                       |                     |                                |                       |                         |
| 1. Military Retirement Fund                   | \$ 226,791,000,712.69 | See Below           | \$ (6,229,574,423.72)          | \$ 220,561,426,288.97 | \$ 209,235,604,929.87   |
| 2. Medicare Eligible Retiree Health Care Fund | 110,891,956,448.18    | See Below           | (1,667,630,146.64)             | 109,224,326,301.54    | 102,513,004,338.31      |
| 3. US Army Corps of Engineers                 | 4,007,285,587.61      | See Below           | (34,158,573.26)                | 3,973,127,014.35      | 3,926,428,988.41        |
| 4. Other Funds                                | 1,971,250,905.14      | See Below           | (10,211,418.91)                | 1,961,039,486.23      | 652,823,510.12          |
| 5. Total Nonmarketable, Market-Based          | 343,661,493,653.62    |                     | (7,941,574,562.53)             | 335,719,919,091.09    | 316,327,861,766.71      |
| <b>B. Accrued Interest</b>                    | 3,255,181,770.44      |                     |                                | 3,255,181,770.44      | 3,255,181,770.44        |
| <b>C. Total Intragovernmental Securities</b>  | \$ 346,916,675,424.06 |                     | \$ (7,941,574,562.53)          | \$ 338,975,100,861.53 | \$ 319,583,043,537.15   |
| <b>2. Other Investments</b>                   |                       |                     |                                |                       |                         |
| <b>A. Total Other Investments</b>             | \$ 1,359,615,130.00   |                     | \$ 0.00                        | \$ 1,359,615,130.00   | N/A                     |
| <b>3. Intragovernmental Securities</b>        |                       |                     |                                |                       |                         |
| <b>A. Nonmarketable, Market-Based</b>         |                       |                     |                                |                       |                         |
| 1. Military Retirement Fund                   | \$ 217,456,958,736.36 | See Below           | \$ (7,421,300,048.25)          | \$ 210,035,658,688.11 | \$ 201,171,804,858.77   |
| 2. Medicare Eligible Retiree Health Care Fund | 86,163,606,227.24     | See Below           | (942,773,063.63)               | 85,220,833,163.61     | 80,469,300,081.13       |
| 3. US Army Corps of Engineers                 | 3,550,109,902.29      | See Below           | (69,035,668.61)                | 3,481,074,233.68      | 3,407,727,531.47        |
| 4. Other Funds                                | 1,868,878,169.74      | See Below           | 2,142,982.63                   | 1,871,021,152.37      | 1,871,083,872.58        |
| 5. Total Nonmarketable, Market-Based          | 309,039,553,035.63    |                     | (8,430,965,797.86)             | 300,608,587,237.77    | 286,919,916,343.95      |
| <b>B. Accrued Interest</b>                    | 3,130,297,976.15      |                     |                                | 3,130,297,976.15      | 3,130,297,976.15        |
| <b>C. Total Intragovernmental Securities</b>  | \$ 312,169,851,011.78 |                     | \$ (8,430,965,797.86)          | \$ 303,738,885,213.92 | \$ 290,050,214,320.10   |
| <b>4. Other Investments</b>                   |                       |                     |                                |                       |                         |
| <b>A. Total Other Investments</b>             | \$ 921,823,130.00     |                     | \$ 0.00                        | \$ 921,823,130.00     | N/A                     |

Amortization Method Used: Effective Interest

**Other Disclosures**

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

Other Funds are comprised of investments in U.S. Treasury securities issued by the Bureau of the Public Debt.

|                |                            |
|----------------|----------------------------|
| <b>Note 5.</b> | <b>Accounts Receivable</b> |
|----------------|----------------------------|

| As of June 30  | 2007                |  |                             | 2006                        |
|--|---------------------|--|-----------------------------|-----------------------------|
|  | Gross Amount Due    | Allowance For<br>Estimated<br>Uncollectibles | Accounts Receivable,<br>Net | Accounts Receivable,<br>Net |
| <b>1. Intragovernmental<br/>Receivables</b>                | \$ 1,630,933,213.63 | N/A  | \$ 1,630,933,213.63         | \$ 3,747,095,998.91         |
| <b>2. Nonfederal<br/>Receivables (From<br/>the Public)</b> | \$ 8,066,163,896.78 | \$ (222,257,798.54)                          | \$ 7,843,906,098.24         | \$ 8,252,007,385.63         |
| <b>3. Total Accounts<br/>Receivable</b>                    | \$ 9,697,097,110.41 | \$ (222,257,798.54)                          | \$ 9,474,839,311.87         | \$ 11,999,103,384.54        |

## Aged Accounts Receivable

| As of June 30   | 2007                       |                            | 4th Quarter 2006            |                            |
|---|----------------------------|----------------------------|-----------------------------|----------------------------|
|   | Intragovernmental          | Nonfederal                 | Intragovernmental           | Nonfederal                 |
| <b>CATEGORY</b>   |                            |                            |                             |                            |
| <b>Nondelinquent</b>                                    |                            |                            |                             |                            |
| Current   | \$ 7,241,204,931.21        | \$ 1,807,413,153.70        | \$ 7,735,558,042.58         | \$ 1,840,827,298.84        |
| Noncurrent  | 179,744,880.64             | 1,751,866,317.57           | 232,111,648.02              | 1,740,931,578.87           |
| <b>Delinquent</b>                                       |                            |                            |                             |                            |
| 1 to 30 days  | \$ 272,731,439.93          | \$ 178,066,777.42          | \$ 321,052,693.18           | \$ 159,895,143.01          |
| 31 to 60 days   | 171,694,213.81             | 70,798,222.44              | 345,741,597.72              | 53,396,849.71              |
| 61 to 90 days   | 47,507,515.89              | 105,957,534.13             | 57,232,711.57               | 117,793,320.90             |
| 91 to 180 days  | 85,343,464.30              | 119,453,749.32             | 716,488,003.02              | 129,963,654.25             |
| 181 days to 1 year                                      | 181,863,755.44             | 218,405,752.25             | 908,685,038.83              | 207,191,912.01             |
| Greater than 1 year and less than or equal to 2 years   | 109,090,779.81             | 179,265,635.12             | 44,433,330.59               | 192,238,715.34             |
| Greater than 2 years and less than or equal to 6 years  | 44,751,262.64              | 908,322,818.66             | 55,010,117.48               | 896,217,986.17             |
| Greater than 6 years and less than or equal to 10 years | 2,804,301.04               | 587,827,195.55             | 1,178,125.70                | 676,041,862.31             |
| Greater than 10 years                                   | 15,422.62                  | 2,686,523,157.27           | 17,933.35                   | 2,640,490,906.55           |
| <b>Subtotal</b>   | <b>\$ 8,336,751,967.33</b> | <b>\$ 8,613,900,313.43</b> | <b>\$ 10,417,509,242.04</b> | <b>\$ 8,654,989,227.96</b> |
| Less Supported Undistributed Collections                | (382,537,058.01)           | (357,432,092.84)           | (492,669,515.07)            | (478,889,512.10)           |
| Less Eliminations                                       | (6,026,903,066.49)         | 0.00                       | (6,986,274,309.01)          | 0.00                       |
| Less Other  | (296,378,629.73)           | (190,304,323.42)           | (10,909,327.79)             | 38,516,930.32              |
| <b>Total</b>  | <b>\$ 1,630,933,213.10</b> | <b>\$ 8,066,163,897.17</b> | <b>\$ 2,927,656,090.17</b>  | <b>\$ 8,214,616,646.18</b> |

The accounts receivable aging schedule prior year column represents 4<sup>th</sup> Quarter, FY 2006, ending balances, rather than the ending balances as of 3<sup>rd</sup> Quarter, FY 2006. Therefore, the prior year accounts receivable balance on the aging schedule will not agree with the prior year balance on the Balance Sheet or the prior year balance in the first schedule in this note.

Nondelinquent noncurrent accounts receivable total \$1.9 billion for 3<sup>rd</sup> Quarter, FY 2007, and represents those amounts that are due beyond the next 12 months. These accounts are not considered delinquent since the associated repayment schedules allow for repayment after a 30-day period and the payments are not yet due under the contract or billing documents pertaining to the receivable.

The Intragovernmental Other line primarily consists of \$291.8 million for pending customer returns and \$6.4 million for interfund clearing accounts offset by \$1.8 million to classify collections and receivables previously reported as Intragovernmental.

The Nonfederal Other line reflects reconciling differences based on subsidiary ledgers with the general ledger.

The Department utilizes several different systems and programs (U. S. Treasury Offset Program, Vendor Pay Offset Program, Central Debt System, Intragovernmental Payment and Collection, Defense Cash Accountability System, Defense Debt Management System, Salary Offset Program), and private collection services to pursue collection action on delinquent and nondelinquent accounts receivable in accordance with Office of Management and Budget Circular A-129, "Policies for Federal Credit Programs and Non-Tax Receivables." In certain instances, the status of litigation impacts the Department's ability to pursue collection actions.

|                |                     |
|----------------|---------------------|
| <b>Note 6.</b> | <b>Other Assets</b> |
|----------------|---------------------|

| As of June 30                              | 2007                               | 2006                               |
|--|------------------------------------|------------------------------------|
| <b>1. Intragovernmental Other Assets</b>   |                                    |                                    |
| A. Advances and Prepayments                | \$ 1,242,337,901.08                | \$ 1,189,083,823.21                |
| B. Other Assets                            | 124,925,000.00                     | 0.00                               |
| C. Total Intragovernmental Other Assets    | <u>\$ 1,367,262,901.08</u>         | <u>\$ 1,189,083,823.21</u>         |
| <b>2. Nonfederal Other Assets</b>          |                                    |                                    |
| A. Outstanding Contract Financing Payments | \$ 24,434,810,004.09               | \$ 22,416,092,537.18               |
| B. Other Assets (With the Public)          | 12,533,963,367.46                  | 2,477,912,763.72                   |
| C. Total Nonfederal Other Assets           | <u>\$ 36,968,773,371.55</u>        | <u>\$ 24,894,005,300.90</u>        |
| <b>3. Total Other Assets</b>               | <u><u>\$ 38,336,036,272.63</u></u> | <u><u>\$ 26,083,089,124.11</u></u> |

Intragovernmental Other Assets consist of the Department's right to approximately 6 million barrels of crude oil held by the Department of Energy (DOE). The Department provided funds to DOE in FY 1993 to acquire the reserve. In 4<sup>th</sup> Quarter, FY 2006, the Department recorded a prior period adjustment and increased the value of Other Assets by \$124.9 million to recognize the right to the oil.

Other Assets (With the Public) are primarily comprised of \$10.3 billion in advances paid to contractors for undelivered defense articles and services.

Outstanding Contract Financing Payments are comprised of \$22.7 billion in contract financing payments and an additional \$1.8 billion in estimated future payments to the contractor contingent upon delivery and Government acceptance. (See additional discussion in Note 15, Other Liabilities).

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

|                |                                       |
|----------------|---------------------------------------|
| <b>Note 7.</b> | <b>Cash and Other Monetary Assets</b> |
|----------------|---------------------------------------|

| As of June 30   | 2007                        | 2006                       |
|---|-----------------------------|----------------------------|
| <b>1. Cash</b>  | \$ 13,961,454,553.80        | \$ 1,342,302,304.54        |
| <b>2. Foreign Currency</b>  | 1,037,010,612.39            | 686,582,969.62             |
| <b>3. Other Monetary Assets</b>                                     | 0.00                        | 0.00                       |
| <b>4. Total Cash, Foreign Currency, &amp; Other Monetary Assets</b> | <u>\$ 14,998,465,166.19</u> | <u>\$ 2,028,885,274.16</u> |

The Department began reporting the accrued assets, liabilities, and expenses of Foreign Military Sales during FY 2007, resulting in the recognition of an additional \$12.3 billion in cash. Approximately \$13.7 billion in cash and an additional \$1.0 billion in foreign currency represent nonentity assets which are restricted, and therefore, unavailable for use in the Department's mission.

## Note 8. Direct Loan and/or Loan Guarantee Programs

As of June 30

### Direct Loan and/or Loan Guarantee Programs

The Department operates the following direct loan and/or loan guarantee programs:

- Military Housing Privatization Initiative
- Armament Retooling and Manufacturing Support Initiative
- Foreign Military Account Program

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.

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

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

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

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

#### Military Housing Privatization Initiative

The Military Housing Privatization Initiative (MHPI) includes both Direct Loan and Loan Guarantee Programs. The Loan Guarantee Program is authorized by the National Defense Authorization Act for FY 1996, Public Law 104-106110, Statute 186, Section 2801 and includes a series of authorities that allow the Department to work with the private sector to renovate and build military family housing. For the Department, MHPI results in construction of new housing built to market standards, more quickly than through the military construction process. One of the goals of the Department is to obtain 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.

#### Armament Retooling and Manufacturing Support Initiative

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

## Foreign Military Account Program

The Foreign Military Account (FMA) is a military assistance program. The FMA program is under the purview of the Department of State (DOS) and is included in its International Affairs Budget request to Office of Management and Budget (OMB). The FMA program, appropriated by the U.S. Congress, is provided to the Department from DOS to execute the authorities of the Foreign Assistance Act, section 503(a) and the Arms Export Control Act, section 23. The Defense Security Cooperation Agency, under the auspices of the Executive Office of the President, administers the FMA program. The FMA program is comprised of: (1) the pre 1992 Foreign Military Loan Liquidating Account; (2) the post 1991 Foreign Military Financing Account, and (3) the post 1991 Military Debt Reduction Financing Account.

Beginning in the 1<sup>st</sup> Quarter, FY 2007, the Department implemented a new requirement from OMB Circular A-136, "Financial Reporting Requirements," which states the Department will include programs executed on behalf of the Executive Office of the President as part of the basic financial statements, rather than in the Other Accompanying Information section of the financial statements.

|  |
|--|
| <b>Summary of Direct Loans and Loan Guarantees</b> |
|--|

| As of June 30  | 2007                       | 2006                       |
|--|----------------------------|----------------------------|
| <b>Loans Receivable</b>                                  |                            |                            |
| <u>Direct Loans</u>                                      |                            |                            |
| 1. Foreign Military Loan Liquidating Account             | \$ 2,746,205,942.58        | \$ 2,930,075,177.28        |
| 2. Military Housing Privatization Initiative             | 195,192,948.51             | 136,954,570.04             |
| 3. Foreign Military Financing Account                    | 19,341,891.01              | 612,124,465.83             |
| 4. Military Debt Reduction Financing Account             | 225,704,439.00             | 221,766,702.10             |
| <u>Defaulted Loan Guarantees</u>                         |                            |                            |
| 5. A. Foreign Military Financing Account                 | 0.00                       | 0.00                       |
| B. Military Housing Privatization Initiative             | 0.00                       | 0.00                       |
| C. Armament Retooling & Manufacturing Support Initiative | 15,553,827.30              | 0.00                       |
| <b>6. Total Loans Receivable</b>                         | <b>\$ 3,201,999,048.40</b> | <b>\$ 3,900,920,915.25</b> |

| As of June 30  | 2007                    | 2006                    |
|--|-------------------------|-------------------------|
| <b>Loan Guarantee Liability</b>                          |                         |                         |
| 1. Foreign Military Liquidating Account                  | \$ 0.00                 | \$ 0.00                 |
| 2. Military Housing Privatization Initiative             | 24,983,924.08           | 29,584,103.06           |
| 3. Armament Retooling & Manufacturing Support Initiative | 12,548,528.55           | 988,651.97              |
| <b>4. Total Loan Guarantee Liability</b>                 | <b>\$ 37,532,452.63</b> | <b>\$ 30,572,755.03</b> |

|                               |
|-------------------------------|
| <b>Direct Loans Obligated</b> |
|-------------------------------|

| As of June 30   | 2007                | 2006                |
|---|---------------------|---------------------|
| <b>Direct Loans Obligated Prior to FY 1992<br/>(Allowance for Loss Method):</b> |                     |                     |
| <b>1. Foreign Military Loan Liquidating Account</b>                             |                     |                     |
| A. Loans Receivable Gross   | \$ 1,433,760,396.57 | \$ 1,698,767,098.92 |
| B. Interest Receivable  | 1,312,445,546.01    | 1,231,308,078.36    |
| C. Foreclosed Property  | 0.00                | 0.00                |
| D. Allowance for Loan Losses  | 0.00                | 0.00                |
| E. Value of Assets Related to Direct Loans, Net                                 | \$ 2,746,205,942.58 | \$ 2,930,075,177.28 |
| <b>Direct Loans Obligated After FY 1991<br/>(Present Value Method):</b>         |                     |                     |
| <b>2. Military Housing Privatization Initiative</b>                             |                     |                     |
| A. Loans Receivable Gross   | \$ 308,077,149.43   | \$ 224,279,415.11   |
| B. Interest Receivable  | 2,113,681.52        | 3,329,629.43        |
| C. Foreclosed Property  | 0.00                | 0.00                |
| D. Allowance for Subsidy Cost (Present Value)                                   | (114,997,882.44)    | (90,654,474.50)     |
| E. Value of Assets Related to Direct Loans                                      | \$ 195,192,948.51   | \$ 136,954,570.04   |
| <b>3. Foreign Military Financing Account</b>                                    |                     |                     |
| A. Loans Receivable Gross   | \$ 0.00             | \$ 262,691,290.00   |
| B. Interest Receivable  | 0.00                | 7,761,927.94        |
| C. Foreclosed Property  | 0.00                | 0.00                |
| D. Allowance for Subsidy Cost (Present Value)                                   | 19,341,891.01       | 341,671,247.89      |
| E. Value of Assets Related to Direct Loans                                      | \$ 19,341,891.01    | \$ 612,124,465.83   |
| <b>4. Military Debt Reduction Financing Account</b>                             |                     |                     |
| A. Loans Receivable Gross   | \$ 512,245,077.27   | \$ 505,552,547.25   |
| B. Interest Receivable  | 23,077,546.22       | 14,834,063.18       |
| C. Foreclosed Property  | 0.00                | 0.00                |
| D. Allowance for Subsidy Cost (Present Value)                                   | (309,618,184.49)    | (298,619,908.33)    |
| E. Value of Assets Related to Direct Loans, Net                                 | \$ 225,704,439.00   | \$ 221,766,702.10   |
| <b>5. Total Direct Loans Receivable</b>   | \$ 3,186,445,221.10 | \$ 3,900,920,915.25 |

**Abnormal Balances**

The abnormal balance in the Allowance for Subsidy Cost for the Foreign Military Financing Account reflects loans that were prepaid in FY 2006 and 2007. Since there are no future loan collections, the allowance for subsidy cost was adjusted to reflect the balance of the cash outflows (the repayment of U.S. Treasury borrowings and interest on the borrowings). This cash outflow will result in an upward reestimate at the end of FY 2007 and will be returned to the U.S. Treasury.

Agency Wide

## Total Amount of Direct Loans Disbursed

| As of June 30                                | 2007                     | 2006                     |
|--|--------------------------|--------------------------|
| <b>Direct Loan Programs</b>                  |                          |                          |
| 1. Military Housing Privatization Initiative | \$ 11,900,000.00         | \$ 82,950,000.00         |
| 2. Foreign Military Financing Account        | 277,609,000.00           | 274,940,000.00           |
| 3. Military Debt Reduction Financing Account | 0.00                     | 0.00                     |
| <b>4. Total</b>                              | <b>\$ 289,509,000.00</b> | <b>\$ 357,890,000.00</b> |

## Subsidy Expense for Post FY 1991 Direct Loan

As of June 30

| 2007   | Interest Differential   | Defaults                  | Fees                      | Other                     | Total                     |
|--|-------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| <b>1. New Direct Loans Disbursed:</b>                |                         |                           |                           |                           |                           |
| Military Housing Privatization Initiative            | \$ 2,126,653.00         | \$ 1,303,433.00           | \$ 0.00                   | \$ 0.00                   | \$ 3,430,086.00           |
| Foreign Military Financing Account                   | 0.00                    | 0.00                      | 0.00                      | 0.00                      | 0.00                      |
| Military Debt Reduction Financing Account            | 0.00                    | 0.00                      | 0.00                      | 0.00                      | 0.00                      |
| <b>Total</b>   | <b>\$ 2,126,653.00</b>  | <b>\$ 1,303,433.00</b>    | <b>\$ 0.00</b>            | <b>\$ 0.00</b>            | <b>\$ 3,430,086.00</b>    |
| 2006   | Interest Differential   | Defaults                  | Fees                      | Other                     | Total                     |
| <b>2. New Direct Loans Disbursed:</b>                |                         |                           |                           |                           |                           |
| Military Housing Privatization Initiative            | \$ 12,992,616.00        | \$ 11,803,838.00          | \$ 0.00                   | \$ 0.00                   | \$ 24,796,454.00          |
| Foreign Military Financing Account                   | 0.00                    | 0.00                      | 0.00                      | 0.00                      | 0.00                      |
| Military Debt Reduction Financing Account            | 0.00                    | 0.00                      | 0.00                      | 0.00                      | 0.00                      |
| <b>Total</b>   | <b>\$ 12,992,616.00</b> | <b>\$ 11,803,838.00</b>   | <b>\$ 0.00</b>            | <b>\$ 0.00</b>            | <b>\$ 24,796,454.00</b>   |
| 2007   | Modifications           | Interest Rate Reestimates | Technical Reestimates     | Total Reestimates         | Total                     |
| <b>3. Direct Loan Modifications and Reestimates:</b> |                         |                           |                           |                           |                           |
| Military Housing Privatization Initiative            | \$ 0.00                 | \$ 234,866.00             | \$ 6,742,155.00           | \$ 6,977,021.00           | \$ 6,977,021.00           |
| Foreign Military Financing Account                   | 0.00                    | 0.00                      | 0.00                      | 0.00                      | 0.00                      |
| Military Debt Reduction Financing Account            | 0.00                    | 0.00                      | 0.00                      | 0.00                      | 0.00                      |
| <b>Total</b>   | <b>\$ 0.00</b>          | <b>\$ 234,866.00</b>      | <b>\$ 6,742,155.00</b>    | <b>\$ 6,977,021.00</b>    | <b>\$ 6,977,021.00</b>    |
| 2006   | Modifications           | Interest Rate Reestimates | Technical Reestimates     | Total Reestimates         | Total                     |
| <b>4. Direct Loan Modifications and Reestimates:</b> |                         |                           |                           |                           |                           |
| Military Housing Privatization Initiative            | \$ 0.00                 | \$ 0.00                   | \$ 0.00                   | \$ 0.00                   | \$ 0.00                   |
| Foreign Military Financing Account                   | 0.00                    | 0.00                      | (17,659,191.19)           | (17,659,191.19)           | (17,659,191.19)           |
| Military Debt Reduction Financing Account            | 0.00                    | 0.00                      | 0.00                      | 0.00                      | 0.00                      |
| <b>Total</b>   | <b>\$ 0.00</b>          | <b>\$ 0.00</b>            | <b>\$ (17,659,191.19)</b> | <b>\$ (17,659,191.19)</b> | <b>\$ (17,659,191.19)</b> |
|  |                         | 2007                      | 2006                      |                           |                           |
| <b>5. Total Direct Loan Subsidy Expense:</b>         |                         |                           |                           |                           |                           |
| Military Housing Privatization Initiative            | \$ 10,407,107.00        | \$ 24,796,454.00          |                           |                           |                           |
| Foreign Military Financing Account                   | 0.00                    | (17,659,191.19)           |                           |                           |                           |
| Military Debt Reduction Financing Account            | 0.00                    | 0.00                      |                           |                           |                           |
| <b>Total</b>   | <b>\$ 10,407,107.00</b> | <b>\$ 7,137,262.81</b>    |                           |                           |                           |

|   |
|---|
| <b>Subsidy Rate for Direct Loans by Program</b> |
|---|

| As of June 30                                 | Interest Differential | Defaults | Fees and other Collections | Other | Total  |
|---|-----------------------|----------|----------------------------|-------|--------|
| <b>Budget Subsidy Rates for Direct Loans:</b> |                       |          |                            |       |        |
| 1. Military Housing Privatization Initiative  | 19.45%                | 8.95%    | 0.00%                      | 0.00% | 28.40% |
| 2. Foreign Military Financing Account         | 0.00%                 | 0.00%    | 0.00%                      | 0.00% | 0.00%  |
| 3. Military Debt Reduction Financing Account  | 0.00%                 | 0.00%    | 0.00%                      | 0.00% | 0.00%  |

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. The subsidy expense reported in the current year also includes modifications and reestimates.

## Schedule for Reconciling Subsidy Cost Allowance Balances for Post FY1991 Direct Loans

| As of June 30   | 2007                     | 2006                      |
|---|--------------------------|---------------------------|
| <b>Beginning Balances, Changes and Ending Balance:</b>  |                          |                           |
| <b>1. Beginning Balance of the Subsidy Cost Allowance</b>   | \$ 49,691,650.37         | \$ 74,898,302.61          |
| <b>2. Add: Subsidy Expense for Direct Loans Disbursed during the Reporting Years by Component</b> |                          |                           |
| A. Interest Rate Differential Costs   | \$ 2,126,653.00          | \$ 12,992,616.00          |
| B. Default Costs (Net of Recoveries)  | 1,303,433.00             | 11,803,838.00             |
| C. Fees and Other Collections   | 0.00                     | 0.00                      |
| D. Other Subsidy Costs  | 0.00                     | 0.00                      |
| <b>E. Total of the above Subsidy Expense Components</b>   | <b>\$ 3,430,086.00</b>   | <b>\$ 24,796,454.00</b>   |
| <b>3. Adjustments</b>   |                          |                           |
| A. Loan Modifications   | \$ 0.00                  | \$ 0.00                   |
| B. Fees Received  | 0.00                     | 0.00                      |
| C. Foreclosed Property Acquired   | 0.00                     | 0.00                      |
| D. Loans Written Off  | (4,998,782.25)           | (24,219,328.70)           |
| E. Subsidy Allowance Amortization   | 350,174,200.80           | (10,213,102.22)           |
| F. Other  | 0.00                     | 0.00                      |
| <b>G. Total of the above Adjustment Components</b>  | <b>\$ 345,175,418.55</b> | <b>\$ (34,432,430.92)</b> |
| <b>4. Ending Balance of the Subsidy Cost Allowance before Re-estimates</b>                        | <b>\$ 398,297,154.92</b> | <b>\$ 65,262,325.69</b>   |
| <b>5. Add or Subtract Subsidy Re-estimates by Component</b>                                       |                          |                           |
| A. Interest Rate Re-estimate  | \$ 234,866.00            | \$ 0.00                   |
| B. Technical/Default Reestimate   | 6,742,155.00             | (17,659,191.19)           |
| <b>C. Total of the above Reestimate Components</b>  | <b>\$ 6,977,021.00</b>   | <b>\$ (17,659,191.19)</b> |
| <b>6. Ending Balance of the Subsidy Cost Allowance</b>  | <b>\$ 405,274,175.92</b> | <b>\$ 47,603,134.50</b>   |

The three foreign countries that have loans with the Department prepaid their entire loan balances in FY 2006 and FY 2007. There will be no further loan collections except for one outstanding loan that currently has no outstanding principal balance. Since there are no future loan collections for the balance of the portfolio, the allowance for subsidy was adjusted to reflect the balance of the cash outflows.

|                                   |
|-----------------------------------|
| <b>Defaulted Guaranteed Loans</b> |
|-----------------------------------|

| As of June 30  | 2007             | 2006    |
|--|------------------|---------|
| <b>Defaulted Guaranteed Loans from Pre-FY 1992 Guarantees (Allowance for Loss Method):</b> |                  |         |
| <b>1. Foreign Military Liquidating Account</b>   |                  |         |
| A. Defaulted Guaranteed Loans Receivable, Gross  | \$ 0.00          | \$ 0.00 |
| B. Interest Receivable   | 0.00             | 0.00    |
| C. Foreclosed Property   | 0.00             | 0.00    |
| D. Allowance for Loan Losses   | 0.00             | 0.00    |
| E. Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net                   | \$ 0.00          | \$ 0.00 |
| <b>Defaulted Guaranteed Loans from Post-FY 1991 Guarantees (Present Value Method):</b>     |                  |         |
| <b>2. Military Housing Privatization Initiative</b>  |                  |         |
| A. Defaulted Guaranteed Loans Receivable, Gross  | \$ 0.00          | \$ 0.00 |
| B. Interest Receivable   | 0.00             | 0.00    |
| C. Foreclosed Property   | 0.00             | 0.00    |
| D. Allowance for Subsidy Cost (Present Value)  | 0.00             | 0.00    |
| E. Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net                   | \$ 0.00          | \$ 0.00 |
| <b>3. Armament Retooling &amp; Manufacturing Support Initiative</b>                        |                  |         |
| A. Defaulted Guaranteed Loans Receivable, Gross  | \$ 14,407,200.02 | \$ 0.00 |
| B. Interest Receivable   | 1,146,627.28     | 0.00    |
| C. Foreclosed Property   | 0.00             | 0.00    |
| D. Allowance for Subsidy Cost (Present Value)  | 0.00             | 0.00    |
| E. Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net                   | \$ 15,553,827.30 | \$ 0.00 |
| <b>4. Total Value of Assets Related to Defaulted Guaranteed Loans Receivable</b>           |                  |         |
|  | \$ 15,553,827.30 | \$ 0.00 |

The value of assets related to defaulted guaranteed loans, totaling \$15.5 million represent payments the Department made on behalf of the borrower for a defaulted loan. This is reported as a loan receivable for defaulted guaranteed loans.

|                                     |
|-------------------------------------|
| <b>Guaranteed Loans Outstanding</b> |
|-------------------------------------|

| As of June 30  | Outstanding Principal of<br>Guaranteed Loans,<br>Face Value | Amount of Outstanding<br>Principal Guaranteed |
|--|---|---|
| <b>Guaranteed Loans Outstanding</b>                      |   |   |
| 1. Military Housing Privatization Initiative             | \$ 549,412,228.00   | \$ 549,412,228.00                             |
| 2. Armament Retooling & Manufacturing Support Initiative | 4,303,551.80  | 3,658,019.03                                  |
| 3. Foreign Military Liquidating Account                  | 1,808,465,116.00  | 1,627,618,604.40                              |
| <b>4. Total</b>  | <b>\$ 2,362,180,895.80</b>                                  | <b>\$ 2,180,688,851.43</b>                    |
| <b>2007</b>  |   |   |
| <b>New Guaranteed Loans Disbursed</b>                    |   |   |
| 1. Military Housing Privatization Initiative             | \$ 0.00   | \$ 0.00                                       |
| 2. Armament Retooling & Manufacturing Support Initiative | 0.00  | 0.00  |
| 3. Foreign Military Liquidating Account                  | 0.00  | 0.00  |
| <b>4. Total</b>  | <b>\$ 0.00</b>  | <b>\$ 0.00</b>                                |
| <b>2006</b>  |   |   |
| <b>New Guaranteed Loans Disbursed</b>                    |   |   |
| 1. Military Housing Privatization Initiative             | \$ 0.00   | \$ 0.00                                       |
| 2. Armament Retooling & Manufacturing Support Initiative | 2,694,156.51  | 2,290,033.03                                  |
| 3. Foreign Military Liquidating Account                  | 0.00  | 0.00  |
| <b>4. Total</b>  | <b>\$ 2,694,156.51</b>                                      | <b>\$ 2,290,033.03</b>                        |

**Liabilities for Post FY 1991 Loan Guarantees, Present Value**

| As of June 30   | 2007                    | 2006                    |
|---|-------------------------|-------------------------|
| <b>Liabilities for Loan Guarantee Programs from Pre-FY 1992 (Allowance for Loss):</b> |                         |                         |
| 1. Foreign Military Liquidating Account   | \$ 0.00                 | \$ 0.00                 |
| <b>2. Total Loan Guarantee Liability (Pre-FY 1992)</b>                                | <b>\$ 0.00</b>          | <b>\$ 0.00</b>          |
| <b>Liabilities for Loan Guarantee Programs Post-FY 1991 (Present Value):</b>          |                         |                         |
| 3. Military Housing Privatization Initiative  | \$ 24,983,924.08        | \$ 29,584,103.06        |
| 4. Armament Retooling & Manufacturing Support Initiative                              | 12,548,528.55           | 988,651.97              |
| <b>5. Total Loan Guarantee Liability (Post-FY 1991)</b>                               | <b>\$ 37,532,452.63</b> | <b>\$ 30,572,755.03</b> |
| <b>6. Total Loan Guarantee Liability</b>  | <b>\$ 37,532,452.63</b> | <b>\$ 30,572,755.03</b> |

Pre1992 loan guarantee liabilities are to be calculated based on the allowance method. Currently no allowances are reported.

## Subsidy Expense for Loan Guarantees by Program

As of June 30

| 2007  | Interest Differential | Defaults                  | Fees                  | Other             | Total           |
|---|-----------------------|---------------------------|-----------------------|-------------------|-----------------|
| <b>1. New Loan Guarantees Disbursed:</b>              |                       |                           |                       |                   |                 |
| Military Housing Privatization Initiative             | \$ 0.00               | \$ 0.00                   | \$ 0.00               | \$ 0.00           | \$ 0.00         |
| Armament Retooling & Manufacturing Support Initiative | 0.00                  | 0.00                      | 0.00                  | 0.00              | 0.00            |
| <b>Total</b>  | \$ 0.00               | \$ 0.00                   | \$ 0.00               | \$ 0.00           | \$ 0.00         |
| 2006  | Interest Differential | Defaults                  | Fees                  | Other             | Total           |
| <b>2. New Loan Guarantees Disbursed:</b>              |                       |                           |                       |                   |                 |
| Military Housing Privatization Initiative             | \$ 0.00               | \$ 0.00                   | \$ 0.00               | \$ 0.00           | \$ 0.00         |
| Armament Retooling & Manufacturing Support Initiative | 0.00                  | 0.00                      | 0.00                  | 0.00              | 0.00            |
| <b>Total</b>  | \$ 0.00               | \$ 0.00                   | \$ 0.00               | \$ 0.00           | \$ 0.00         |
| 2007  | Modifications         | Interest Rate Reestimates | Technical Reestimates | Total Reestimates | Total           |
| <b>3. Modifications and Reestimates:</b>              |                       |                           |                       |                   |                 |
| Military Housing Privatization Initiative             | \$ 0.00               | \$ 0.00                   | \$ 1,313,752.35       | \$ 1,313,752.35   | \$ 1,313,752.35 |
| Armament Retooling & Manufacturing Support Initiative | 0.00                  | 0.00                      | 0.00                  | 0.00              | 0.00            |
| <b>Total</b>  | \$ 0.00               | \$ 0.00                   | \$ 1,313,752.35       | \$ 1,313,752.35   | \$ 1,313,752.35 |
| 2006  | Modifications         | Interest Rate Reestimates | Technical Reestimates | Total Reestimates | Total           |
| <b>4. Modifications and Reestimates:</b>              |                       |                           |                       |                   |                 |
| Military Housing Privatization Initiative             | \$ 906,670.74         | \$ 0.00                   | \$ 0.00               | \$ 0.00           | \$ 906,670.74   |
| Armament Retooling & Manufacturing Support Initiative | 0.00                  | 0.00                      | 0.00                  | 0.00              | 0.00            |
| <b>Total</b>  | \$ 906,670.74         | \$ 0.00                   | \$ 0.00               | \$ 0.00           | \$ 906,670.74   |
| 2007  |                       |                           |                       |                   | 2006            |
| <b>5. Total Loan Guarantee:</b>                       |                       |                           |                       |                   |                 |
| Military Housing Privatization Initiative             | \$ 1,313,752.35       | \$ 906,670.74             |                       |                   |                 |
| Armament Retooling & Manufacturing Support Initiative | 0.00                  | 0.00                      |                       |                   |                 |
| <b>Total</b>  | \$ 1,313,752.35       | \$ 906,670.74             |                       |                   |                 |

## Subsidy Rates for Loan Guarantees by Program

| As of June 30  | Interest Supplements | Defaults | Fees and other Collections | Other | Total |
|--|----------------------|----------|----------------------------|-------|-------|
| <b>Budget Subsidy Rates for Loan Guarantees:</b>         |                      |          |                            |       |       |
| 1. Military Housing Privatization Initiative             | 0.00%                | 0.00%    | 0.00%                      | 0.00% | 0.00% |
| 2. Armament Retooling & Manufacturing Support Initiative | 0.00%                | 0.00%    | 0.00%                      | 0.00% | 0.00% |

The subsidy rates disclosed pertain only to loan agreements made during the current fiscal year. These rates cannot be applied to the guarantees of loans disbursed during the current reporting 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.

There are no new loan guarantees in FY 2007.

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

| As of June 30   | 2007               | 2006               |
|---|--------------------|--------------------|
| <b>Beginning Balance, Changes, and Ending Balance:</b>  |                    |                    |
| <b>1. Beginning Balance of the Loan Guarantee Liability</b>   | \$ 36,737,916.80   | \$ 41,071,277.64   |
| <b>2. Add: Subsidy Expense for Guaranteed Loans Disbursed during the Reporting Years by Component</b> |                    |                    |
| A. Interest Supplement Costs  | \$ 0.00            | \$ 0.00            |
| B. Default Costs (Net of Recoveries)  | 15,553,827.30      | 0.00               |
| C. Fees and Other Collections   | 0.00               | 0.00               |
| D. Other Subsidy Costs  | 0.00               | 0.00               |
| <b>E. Total of the above Subsidy Expense Components</b>   | \$ 15,553,827.30   | \$ 0.00            |
| <b>3. Adjustments</b>   |                    |                    |
| A. Loan Guarantee Modifications   | \$ 0.00            | \$ 0.00            |
| B. Fees Received  | 0.00               | 0.00               |
| C. Interest Supplements Paid  | (1,146,627.28)     | 0.00               |
| D. Foreclosed Property and Loans Acquired   | 0.00               | 0.00               |
| E. Claim Payments to Lenders  | (14,407,200.02)    | (11,436,224.60)    |
| F. Interest Accumulation on the Liability Balance   | 1,009,483.18       | 937,701.99         |
| G. Other  | (214,947.35)       | 0.00               |
| <b>H. Total of the above Adjustments</b>  | \$ (14,759,291.47) | \$ (10,498,522.61) |
| <b>4. Ending Balance of the Loan Guarantee Liability before Reestimates</b>                           | \$ 37,532,452.63   | \$ 30,572,755.03   |
| <b>5. Add or Subtract Subsidy Reestimates by Component</b>  |                    |                    |
| A. Interest Rate Reestimate   | 0.00               | 0.00               |
| B. Technical/default Reestimate   | 0.00               | 0.00               |
| <b>C. Total of the above Reestimate Components</b>  | \$ 0.00            | \$ 0.00            |
| <b>6. Ending Balance of the Loan Guarantee Liability</b>  | \$ 37,532,452.63   | \$ 30,572,755.03   |

## **Administrative Expenses**

Administrative Expenses are limited to separately identified expenses administered for preFY 1992 and postFY 1991 Direct Loans and Loan Guarantee Programs. The Department does not maintain a separate program to capture the expenses related to direct loans and loan guarantees for MHPI and the Foreign Military Accounts. Administrative expenses for the ARMS Initiative represent a fee paid to U.S. Department of Agriculture, Rural Business Cooperative Service for administering the loan guarantee under ARMS Initiative.

|                |                                       |
|----------------|---------------------------------------|
| <b>Note 9.</b> | <b>Inventory and Related Property</b> |
|----------------|---------------------------------------|

| As of June 30                          | 2007                         | 2006                         |
|--|------------------------------|------------------------------|
| 1. Inventory, Net                      | \$ 84,102,501,792.47         | \$ 81,878,170,164.27         |
| 2. Operating Materials & Supplies, Net | 136,623,298,659.10           | 142,652,056,841.62           |
| 3. Stockpile Materials, Net            | 909,973,620.82               | 1,105,960,332.00             |
| <b>4. Total</b>                        | <b>\$ 221,635,774,072.39</b> | <b>\$ 225,636,187,337.89</b> |

|                       |
|-----------------------|
| <b>Inventory, Net</b> |
|-----------------------|

| As of June 30                          | 2007                         |                               |                          | 2006                        | Valuation Method |
|--|------------------------------|-------------------------------|--------------------------|-----------------------------|------------------|
|  | Inventory, Gross Value       | Revaluation Allowance         | Inventory, Net           | Inventory, Net              |                  |
| <b>1. Inventory Categories</b>         |                              |                               |                          |                             |                  |
| A. Available and Purchased for Resale  | \$ 86,827,938,497.15         | \$ (25,257,749,849.89)        | 61,570,188,647.26        | \$ 55,959,086,475.87        | LAC,MAC          |
| B. Held for Repair                     | 31,090,049,239.73            | (9,240,704,526.15)            | 21,849,344,713.58        | 25,171,209,320.74           | LAC,MAC          |
| C. Excess, Obsolete, and Unserviceable | 7,094,930,434.59             | (7,094,930,434.59)            | 0.00                     | 0.00                        | NRV              |
| D. Raw Materials                       | 86,960,932.74                | 0.00                          | 86,960,932.74            | 51,317,612.92               | MAC,SP,LAC       |
| E. Work in Process                     | 596,007,498.89               | 0.00                          | 596,007,498.89           | 696,556,754.74              | AC               |
| <b>F. Total</b>                        | <b>\$ 125,695,886,603.10</b> | <b>\$ (41,593,384,810.63)</b> | <b>84,102,501,792.47</b> | <b>\$ 81,878,170,164.27</b> |                  |

**Legend for Valuation Methods:**

Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses  
 SP = Standard Price  
 AC = Actual Cost

NRV = Net Realizable Value  
 O = Other  
 MAC = Moving Average Cost

**Restrictions**

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 directives.
- War reserve material includes fuels and subsistence items that are considered restricted.
- Inventory, with the exception of safety stocks, may be sold to foreign, state and local governments, private parties, and contractors in accordance with the current policies and guidance or at the direction of the President.
- Dispositions related to pending litigation or negotiation with contractors or common carriers.

**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 and eventual sale;
- In the process of production for sale; or
- To be consumed in the production of goods for sale or in the provision of service for a fee.

The Department assigns inventory items to a category based upon the type and condition of the asset.

## Operating Materials and Supplies, Net

| As of June 30                          | 2007                         |                              |                              | 2006                         | Valuation Method |
|--|------------------------------|------------------------------|------------------------------|------------------------------|------------------|
|  | OM&S Gross Value             | Revaluation Allowance        | OM&S, Net                    | OM&S, Net                    |                  |
| <b>1. OM&amp;S Categories</b>          |                              |                              |                              |                              |                  |
| A. Held for Use                        | \$ 120,625,217,795.17        | \$ (14,863.04)               | \$ 120,625,202,932.13        | \$ 126,678,188,818.61        | SP, LAC, MAC     |
| B. Held for Repair                     | 17,133,539,712.51            | (1,135,443,985.54)           | 15,998,095,726.97            | 15,973,868,023.01            | SP, LAC, MAC     |
| C. Excess, Obsolete, and Unserviceable | 3,015,241,143.26             | (3,015,241,143.26)           | 0.00                         | 0.00                         | NRV              |
| <b>D. Total</b>                        | <b>\$ 140,773,998,650.94</b> | <b>\$ (4,150,699,991.84)</b> | <b>\$ 136,623,298,659.10</b> | <b>\$ 142,652,056,841.62</b> |                  |

### Legend for Valuation Methods:

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

SP = Standard Price

AC = Actual Cost

NRV = Net Realizable Value

O = Other

MAC = Moving Average Cost

### Restrictions

Some munitions included in Operating Material and Supplies (OM&S) are restricted due to condition or Host Nation Support. Restricted munitions are considered obsolete or unserviceable when they cannot be expected to meet performance requirements. Host Nation Support OM&S includes munitions held in support of defending foreign nations. Obsolete, unserviceable, and Host Nation Support OM&S may be used in emergency combat situations in which no other suitable munitions are immediately available.

### General Composition of Operating Materials and Supplies

The OM&S includes spare and repair parts, ammunition, tactical missiles, aircraft configuration pods, and centrally managed aircraft engines held for consumption.

The Department assigns OM&S items to a category based upon the type and condition of the asset.

## Stockpile Materials, Net

| As of June 30                            | 2007                             |                                 |                             | 2006                        |                     |
|--|----------------------------------|---------------------------------|-----------------------------|-----------------------------|---------------------|
|  | Stockpile<br>Materials<br>Amount | Allowance for Gains<br>(Losses) | Stockpile<br>Materials, Net | Stockpile<br>Materials, Net | Valuation<br>Method |
| <b>1. Stockpile Materials Categories</b> |                                  |                                 |                             |                             |                     |
| A. Held for Sale                         | \$ 880,649,469.91                | \$ 0.00                         | \$ 880,649,469.91           | \$ 1,011,878,943.18         | AC, LCM             |
| B. Held in Reserve for Future Sale       | 29,324,150.91                    | 0.00                            | 29,324,150.91               | 94,081,388.82               | AC, LCM             |
| C. Total                                 | \$ 909,973,620.82                | \$ 0.00                         | \$ 909,973,620.82           | \$ 1,105,960,332.00         |                     |

### Legend for Valuation Methods:

LAC = Latest Acquisition Cost  
 SP = Standard Price  
 AC = Actual Cost

NRV = Net Realizable Value  
 LCM = Lower of Cost or Market  
 O = Other

### Restrictions

Stockpile materials held by the National Defense Stockpile (NDS) are restricted until relieved by congressional action and made available for sale on the open market. Stockpile materials may not be disposed of except under the following conditions: (1) necessary upgrading, refining, or processing, (2) necessary rotation to prevent deterioration, (3) determination as excess with potential financial loss if retained, or (4) as authorized by law.

Mercury sales were voluntarily suspended by the NDS in 1994. The suspension was in response to concerns raised by the U.S. Environmental Protection Agency regarding the accumulation of mercury in the global environment. An Environmental Impact Statement was issued and storage consolidation at Hawthorne, Nevada, was the selected alternative.

Additional restrictions on the use of material are being proposed in the Requirements Report to Congress for beryllium metal, mica block, and quartz.

### 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.

The Annual Materiel Plan lists the maximum quantity of each commodity that may be sold by the Department in a given fiscal year. Before any materials may be sold, Congress must enact specific enabling legislation (e.g., the National Defense Authorization Act). When NDS receives authorization to offer materials for sale, NDS removes the materials from Material Held in Reserve and reclassifies them as Materiel Held for Sale. The estimated market price of the stockpile materials held for sale is \$1.3 billion.

**Note 10. General PP&E, Net**

| As of June 30                                  | 2007                                    |                 |                              |  |                              | 2006                         |
|--|---|-----------------|------------------------------|--|------------------------------|------------------------------|
|  | Depreciation/<br>Amortization<br>Method | Service<br>Life | Acquisition<br>Value         | (Accumulated<br>Depreciation/<br>Amortization) | Net Book<br>Value            | Prior FY Net<br>Book Value   |
| <b>1. Major Asset Classes</b>                  |   |                 |                              |  |                              |                              |
| A. Land  | N/A                                     | N/A             | \$ 10,501,709,916.40         | N/A  | \$ 10,501,709,916.40         | \$ 10,503,557,492.91         |
| B. Buildings,<br>Structures, and<br>Facilities | S/L                                     | 20 Or 40        | 170,792,752,716.10           | \$ (100,182,099,323.09)                        | 70,610,653,393.01            | 69,297,464,756.98            |
| C. Leasehold<br>Improvements                   | S/L                                     | lease term      | 495,721,984.76               | (311,911,339.23)                               | 183,810,645.53               | 168,436,687.81               |
| D. Software                                    | S/L                                     | 2-5 Or 10       | 9,155,599,922.19             | (5,658,846,510.44)                             | 3,496,753,411.75             | 3,782,161,506.66             |
| E. General<br>Equipment                        | S/L                                     | 5 or 10         | 62,089,340,629.41            | (45,883,219,061.75)                            | 16,206,121,567.66            | 17,832,199,961.08            |
| F. Military Equipment                          | S/L                                     | Various         | 656,388,485,733.78           | (309,303,732,496.33)                           | 347,084,753,237.45           | 325,740,000,000.00           |
| G. Assets Under<br>Capital Lease               | S/L                                     | lease term      | 877,558,689.11               | (496,241,794.18)                               | 381,316,894.93               | 164,113,209.34               |
| H. Construction-in-<br>Progress                | N/A                                     | N/A             | 19,404,361,289.00            | N/A  | 19,404,361,289.00            | 20,376,197,028.97            |
| I. Other                                       |   |                 | 62,090,540.85                | (1,213,445.24)                                 | 60,877,095.61                | 65,253,249.00                |
| J. Total General<br>PP&E                       |   |                 | <u>\$ 929,767,621,421.60</u> | <u>\$ (461,837,263,970.26)</u>                 | <u>\$ 467,930,357,451.34</u> | <u>\$ 447,929,383,892.75</u> |

<sup>1</sup> Note 15 for additional information on Capital Leases

**Legend for Valuation Methods:**

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

**Military Equipment**

In accordance with the requirements of Statement of Federal Financial Accounting Standards (SFFAS) No. 23, "Eliminating the Category National Defense Property, Plant, and Equipment," beginning in FY 2003, the Department capitalized military equipment into General Property, Plant, and Equipment (PP&E) at estimated historical cost using information obtained from the Bureau of Economic Analysis (BEA). Effective 3<sup>rd</sup> Quarter, FY 2006, the Department replaced the BEA estimation methodology with one that is based on departmental internal records for military equipment.

**Heritage Assets and Stewardship Land**

The Federal Accounting Standards Advisory Board, SFFAS No. 29, "Heritage Assets and Stewardship Land," requires note disclosures for these types of assets. The Department's policy is to preserve and account for its heritage assets' historical, cultural, educational, or artistic importance. Additionally, the Department possesses and maintains land not acquired in connection with General PP&E, land donated to the Federal Government, and land previously recorded as public domain.

Heritage Assets within the Department consist of buildings and structures, museums, major collections, monuments and memorials, and archeological sites and cemeteries. Stewardship Land consists mainly of mission essential (donated, public domain, executive order) land. The Department, with minor exceptions, uses most of the buildings and structures as part of its everyday activities and includes them on the Balance Sheet as multi-use heritage assets (capitalized and depreciated).

**Other Disclosures**

The Department has the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. The Department is restricted by treaty covenants regarding the use and disposal of real property (land and buildings) located outside the continental United States.

The Department does not have the acquisition value for all PP&E and uses several cost methodologies to provide real property values for financial statement reporting purposes.

Other assets primarily consist of assets awaiting disposal of \$32.7 million and the projected value of forest product sales of \$24.1 million.

|                                   |
|-----------------------------------|
| <b>Assets Under Capital Lease</b> |
|-----------------------------------|

| As of June 30  | 2007              | 2006              |
|--|-------------------|-------------------|
| <b>1. Entity as Lessee, Assets Under Capital Lease</b> |                   |                   |
| A. Land and Buildings                                  | \$ 572,058,472.67 | \$ 619,551,791.97 |
| B. Equipment   | 305,500,216.44    | 27,864,763.63     |
| C. Accumulated Amortization                            | (496,241,794.18)  | (483,303,346.26)  |
| D. Total Capital Leases                                | \$ 381,316,894.93 | \$ 164,113,209.34 |

|                 |   |
|-----------------|---|
| <b>Note 11.</b> | <b>Liabilities Not Covered by Budgetary Resources</b> |
|-----------------|---|

| As of June 30   | 2007                           | 2006                           |
|---|--------------------------------|--------------------------------|
| <b>1. Intragovernmental Liabilities</b>                         |                                |                                |
| A. Accounts Payable   | \$ 765,737.75                  | \$ 798,847.71                  |
| B. Debt   | 1,838,143,703.17               | 1,835,248,217.50               |
| C. Other  | 7,940,848,523.43               | 7,677,714,432.39               |
| <b>D. Total Intragovernmental Liabilities</b>                   | <b>\$ 9,779,757,964.35</b>     | <b>\$ 9,513,761,497.60</b>     |
| <b>2. Nonfederal Liabilities</b>                                |                                |                                |
| A. Accounts Payable   | \$ 293,298,435.08              | \$ 257,729,100.53              |
| B. Military Retirement and<br>Other Federal Employment Benefits | 1,478,393,703,102.40           | 1,440,390,680,713.87           |
| C. Environmental Liabilities                                    | 67,813,880,662.61              | 68,961,658,657.16              |
| D. Other Liabilities  | 14,186,661,061.84              | 13,492,105,510.79              |
| <b>E. Total Nonfederal Liabilities</b>                          | <b>\$ 1,560,687,543,261.90</b> | <b>\$ 1,523,102,173,982.40</b> |
| <b>3. Total Liabilities Not Covered by Budgetary Resources</b>  | <b>\$ 1,570,467,301,226.30</b> | <b>\$ 1,532,615,935,480.00</b> |
| <b>4. Total Liabilities Covered by Budgetary Resources</b>      | <b>\$ 421,058,553,790.24</b>   | <b>\$ 352,049,118,046.75</b>   |
| <b>5. Total Liabilities</b>                                     | <b>\$ 1,991,525,855,016.50</b> | <b>\$ 1,884,665,053,526.80</b> |

Liabilities Not Covered by Budgetary Resources are those liabilities which are not legally obligated with realized budgetary resources as of the Balance Sheet date. These are liabilities with due dates extending past the budget life cycle of appropriations currently funded and received. The Department expects to receive appropriations to cover these liabilities in future budget years.

Military Retirement and Other Federal Employment Benefits not covered by budgetary resources are comprised of various employee actuarial liabilities not due and payable during the current fiscal year. These liabilities are primarily comprised of \$743.4 billion in pension liabilities and \$727.1 billion in health benefit liabilities. Refer to Note 17, Military Retirement and Other Federal Employment Benefits, for additional details and disclosures.

Intragovernmental Liabilities Other are primarily comprised of \$6.2 billion in custodial liabilities from accounts receivable for cancelled appropriations and interest, penalties, fines, and administrative fees from the public. The amounts collected cannot be used by the Department and must be distributed to the U.S. Treasury. Intragovernmental Liabilities Other also includes \$1.2 billion in unfunded Federal Employees Compensation Act liabilities that are not due during FY 2007.

Nonfederal Other Liabilities are primarily comprised of \$9.1 billion in unfunded annual leave liabilities and \$2.7 billion in contingent liabilities.

|                 |                         |
|-----------------|-------------------------|
| <b>Note 12.</b> | <b>Accounts Payable</b> |
|-----------------|-------------------------|

| As of June 30                          | 2007                        |  |                             | 2006                        |
|--|-----------------------------|--|-----------------------------|-----------------------------|
|  | Accounts Payable            | Interest, Penalties, and Administrative Fees | Total                       | Total                       |
| 1. Intragovernmental Payables          | \$ 1,854,342,538.79         | \$ N/A                                       | \$ 1,854,342,538.79         | \$ 2,216,027,051.25         |
| 2. Nonfederal Payables (to the Public) | 24,830,714,456.01           | 2,636,603.26                                 | 24,833,351,059.27           | 27,256,142,870.83           |
| <b>3. Total</b>                        | <b>\$ 26,685,056,994.80</b> | <b>\$ 2,636,603.26</b>                       | <b>\$ 26,687,693,598.06</b> | <b>\$ 29,472,169,922.08</b> |

|                 |             |
|-----------------|-------------|
| <b>Note 13.</b> | <b>Debt</b> |
|-----------------|-------------|

| As of June 30                             | 2007                |                   |                     | 2006               |                     |
|---|---------------------|-------------------|---------------------|--------------------|---------------------|
|   | Beginning Balance   | Net Borrowing     | Ending Balance      | Net Borrowing      | Ending Balance      |
| <b>1. Agency Debt (Intragovernmental)</b> |                     |                   |                     |                    |                     |
| A. Debt to the Treasury                   | \$ 586,316,969.73   | \$ 18,266,375.19  | \$ 604,583,344.92   | \$ 64,852,439.77   | \$ 959,306,543.35   |
| B. Debt to the Federal Financing Bank     | 2,919,430,014.40    | (25,689,418.70)   | 2,893,740,595.70    | (115,524,674.03)   | 3,196,068,893.28    |
| C. Total Agency Debt                      | \$ 3,505,746,984.13 | \$ (7,423,043.51) | \$ 3,498,323,940.62 | \$ (50,672,234.26) | \$ 4,155,375,436.63 |
| <b>2. Total Debt</b>                      | \$ 3,505,746,984.13 | \$ (7,423,043.51) | \$ 3,498,323,940.62 | \$ (50,672,234.26) | \$ 4,155,375,436.63 |

**Other Information Related to Debt**

The outstanding debt consists of interest and principal payments due to the U.S. Treasury and the Federal Financing Bank. The Department borrows funds for Security Assistance, Navy - Ship Leasing and the Military Housing Privatization Initiative.

The majority of the debt represents direct and guaranteed loans to foreign countries for pre1992 and post1991 loans. The Federal Credit Reform Act (FCRA) of 1990 governs all direct loan obligations and loan guarantee commitments made after FY 1991. Before 1992, funds were borrowed from the Federal Financing Bank to either directly loan the funds to foreign countries or to reimburse guaranteed loans defaulted. Beginning in 1992, based on the FCRA, the security assistance program began borrowing the funds from the U.S. Treasury.

The Department must pay the debt if borrowers (e.g. foreign country, ship leasing, or housing builder) default on the loan. For loan guarantees, the Department must pay the amount of outstanding principal guaranteed.

**Other Disclosures**

Beginning in the 1<sup>st</sup> Quarter, FY 2007, the Department implemented a new requirement from the Office of Management and Budget Circular A-136, "Financial Reporting Requirements," which states that the Department will include programs executed on behalf of the Executive Office of the President as part of the basic financial statements, rather than in the Other Accompanying Information section of the financial statements.

|                 |   |
|-----------------|---|
| <b>Note 14.</b> | <b>Environmental Liabilities and Disposal Liabilities</b> |
|-----------------|---|

| As of June 30   | 2007                    |                             |                             | 2006                        |
|---|-------------------------|-----------------------------|-----------------------------|-----------------------------|
|   | Current Liability       | Noncurrent Liability        | Total                       | Total                       |
| <b>1. Environmental Liabilities--</b>   |                         |                             |                             |                             |
| <b>Nonfederal</b>   |                         |                             |                             |                             |
| A. Accrued Environmental Restoration Liabilities  |                         |                             |                             |                             |
| 1. Active Installations—Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR) |                         |                             |                             |                             |
| \$  | 1,171,152,342.22        | \$ 7,428,104,531.34         | \$ 8,599,256,873.56         | \$ 9,349,400,735.26         |
| 2. Active Installations—Military Munitions Response Program (MMRP)  |                         |                             |                             |                             |
|   | 110,437,845.00          | 5,380,215,359.49            | 5,490,653,204.49            | 7,237,874,000.00            |
| 3. Formerly Used Defense Sites—IRP and BD/DR  |                         |                             |                             |                             |
|   | 131,219,000.00          | 3,921,393,000.00            | 4,052,612,000.00            | 4,106,194,000.00            |
| 4. Formerly Used Defense Sites--MMRP  |                         |                             |                             |                             |
|   | 77,536,000.00           | 14,638,340,000.00           | 14,715,876,000.00           | 14,537,564,000.00           |
| B. Other Accrued Environmental Liabilities—Active Installations   |                         |                             |                             |                             |
| 1. Environmental Corrective Action  |                         |                             |                             |                             |
|   | 63,688,675.73           | 676,324,518.18              | 740,013,193.91              | 644,605,712.46              |
| 2. Environmental Closure Requirements   |                         |                             |                             |                             |
|   | 7,643,300.00            | 989,162,664.00              | 996,805,964.00              | 371,707,594.00              |
| 3. Environmental Response at Operational Ranges   |                         |                             |                             |                             |
|   | 32,082,000.00           | 236,113,990.00              | 268,195,990.00              | 304,085,000.00              |
| 4. Other  |                         |                             |                             |                             |
|   | 70,523,938.31           | 686,410,932.74              | 756,934,871.05              | 737,955,845.59              |
| C. Base Realignment and Closure (BRAC)  |                         |                             |                             |                             |
| 1. Installation Restoration Program   |                         |                             |                             |                             |
|   | 272,713,552.67          | 3,139,776,525.32            | 3,412,490,077.99            | 2,869,806,628.88            |
| 2. Military Munitions Response Program  |                         |                             |                             |                             |
|   | 15,605,744.00           | 933,341,651.00              | 948,947,395.00              | 735,797,000.00              |
| 3. Environmental Corrective Action / Closure Requirements   |                         |                             |                             |                             |
|   | 30,414,542.00           | 159,065,197.27              | 189,479,739.27              | 262,069,842.96              |
| 4. Other  |                         |                             |                             |                             |
|   | 163,653,000.00          | 0.00                        | 163,653,000.00              | 360,061,720.56              |
| D. Environmental Disposal for Weapons Systems Programs  |                         |                             |                             |                             |
| 1. Nuclear Powered Aircraft Carriers  |                         |                             |                             |                             |
|   | 0.00                    | 5,668,309,534.27            | 5,668,309,534.27            | 5,604,268,445.64            |
| 2. Nuclear Powered Submarines   |                         |                             |                             |                             |
|   | 484,006,242.85          | 3,202,361,597.94            | 3,686,367,840.79            | 3,376,302,131.70            |
| 3. Other Nuclear Powered Ships  |                         |                             |                             |                             |
|   | 226,908,489.60          | 66,535,508.00               | 293,443,997.60              | 277,607,852.00              |
| 4. Other National Defense Weapons Systems   |                         |                             |                             |                             |
|   | 784,227.00              | 206,966,508.70              | 207,750,735.70              | 237,699,405.71              |
| 5. Chemical Weapons Disposal Program  |                         |                             |                             |                             |
|   | 1,650,665,000.00        | 17,240,517,000.00           | 18,891,182,000.00           | 17,976,921,000.00           |
| 6. Other  |                         |                             |                             |                             |
|   | 0.00                    | 3,237,406,105.00            | 3,237,406,105.00            | 3,237,406,105.00            |
| <b>2. Total Environmental Liabilities</b>   |                         |                             |                             |                             |
| <b>\$</b>   | <b>4,509,033,899.38</b> | <b>\$ 67,810,344,623.25</b> | <b>\$ 72,319,378,522.63</b> | <b>\$ 72,227,327,019.76</b> |

| Service Component – Environmental Restoration (Cleanup) Liabilities and Environmental Disposal Liabilities<br>(Amounts in millions) | Army               | Navy               | Air Force         | ODO             | Total              |
|---|--------------------|--------------------|-------------------|-----------------|--------------------|
| <b>1. Environmental Liabilities-Nonfederal</b>  |                    |                    |                   |                 |                    |
| A. Accrued Environmental Restoration Liabilities:   |                    |                    |                   |                 |                    |
| 1. Active Installations--Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)                  | \$ 2,691.8         | \$ 2,311.4         | \$ 3,376.3        | \$ 219.8        | \$ 8,599.3         |
| 2. Active Installations--Military Munitions Response Program (MMRP)   | 3,302.5            | 794.4              | 1,393.7           | 0.0             | 5,490.6            |
| 3. Formerly Used Defense Sites--IRP and BD/DR   | 4,052.6            | 0.0                | 0.0               | 0.0             | 4,052.6            |
| 4. Formerly Used Defense Sites--MMRP  | 14,715.9           | 0.0                | 0.0               | 0.0             | 14,715.9           |
| B. Other Accrued Environmental Liabilities--Active Installations  |                    |                    |                   |                 |                    |
| 1. Environmental Corrective Action  | 404.8              | 46.6               | 129.3             | 159.3           | 740.0              |
| 2. Environmental Closure Requirements   | 96.9               | 773.8              | 99.5              | 26.6            | 996.8              |
| 3. Environmental Response at Operational Ranges   | 226.0              | 41.3               | 0.0               | 0.9             | 268.2              |
| 4. Other  | 672.1              | 2.6                | 0.0               | 82.2            | 756.9              |
| C. Base Realignment and Closure (BRAC)  |                    |                    |                   |                 |                    |
| 1. Installation Restoration Program   | 523.7              | 1,723.5            | 1,125.9           | 39.4            | 3,412.5            |
| 2. Military Munitions Response Program  | 800.3              | 148.6              | 0.0               | 0.0             | 948.9              |
| 3. Environmental Corrective Action/Closure Requirements   | 32.3               | 81.1               | 76.1              | 0.0             | 189.5              |
| 4. Other  | 163.7              | 0.0                | 0.0               | 0.0             | 163.7              |
| D. Environmental Disposal for Weapons Systems Programs  |                    |                    |                   |                 |                    |
| 1. Nuclear Powered Aircraft Carriers  | 0.0                | 5,668.3            | 0.0               | 0.0             | 5,668.3            |
| 2. Nuclear Powered Submarines   | 0.0                | 3,686.4            | 0.0               | 0.0             | 3,686.4            |
| 3. Other Nuclear Powered Ships  | 0.0                | 293.4              | 0.0               | 0.0             | 293.4              |
| 4. Other National Defense Weapons Systems   | 0.0                | 207.8              | 0.0               | 0.0             | 207.8              |
| 5. Chemical Weapons Disposal Program  | 18,891.2           | 0.0                | 0.0               | 0.0             | 18,891.2           |
| 6. Other  | 0.0                | 3,237.4            | 0.0               | 0.0             | 3,237.4            |
| <b>2. Total Nonfederal Environmental Liabilities:</b>   | <b>\$ 46,573.8</b> | <b>\$ 19,016.6</b> | <b>\$ 6,200.8</b> | <b>\$ 528.2</b> | <b>\$ 72,319.4</b> |

**Others Category Disclosure Comparative Table**

| Types<br>(Amounts in millions)  | June 30, 2007    | June 30, 2006    |
|---|------------------|------------------|
| <b>Other Accrued Environmental Liabilities-Active Installations-Other</b>   |                  |                  |
| U.S. Army Corps of Engineers (USACE) remediation of the Formerly Utilized Sites Remedial Action Program (FUSRAP)            | \$619.5          | \$618.4          |
| USACE environmental liabilities not related to FUSRAP   | 6.0              | 0.0              |
| Army Low Level Radioactive Waste Program  | 46.6             | 28.8             |
| National Defense Stockpile Transaction  | 49.1             | 50.0             |
| Defense Commissary Agency – asbestos and/or lead based paint  | 32.9             | 29.7             |
| TRICARE Management Activity Uniformed Services University of Health Sciences - disposal liability for research laboratories | 0.0              | 10.9             |
| Under Secretary of Defense - Operation and Maintenance - ODO  | .2               | .2               |
| Navy estimate for disposal of Polychlorinated Biphenyls transformers.   | 2.6              | 0.0              |
| <b>Total</b>  | <b>\$756.9</b>   | <b>\$738.0</b>   |
| <b>Base Realignment and Closure (BRAC)-Other</b>  |                  |                  |
| Army unliquidated obligations associated with clean-up contracts at BRAC installations                                      | \$163.7          | \$145.9          |
| Air Force contractual support for environmental program management at BRAC installations                                    | 0.0              | 214.1            |
| <b>Total</b>  | <b>\$163.7</b>   | <b>\$360.0</b>   |
| <b>Environmental Disposal for Weapons Systems Programs-Other</b>  |                  |                  |
| Navy spent nuclear fuel   | \$3,237.4        | \$3,237.4        |
| <b>Total</b>  | <b>\$3,237.4</b> | <b>\$3,237.4</b> |

Other Accrued Environmental Liabilities, Active Installations, Other primarily consists of remediation related to FUSRAP. The USACE is responsible for FUSRAP, which responds to radiological contamination from the early U.S. Atomic Energy and Weapons Program with the Department of Energy. This program is funded through a Civil Works appropriation.

The BRAC, Other consists of unliquidated obligations associated with clean-up contracts at BRAC installations. The unliquidated obligations cannot be categorized within the BRAC program lines above.

Environmental Disposal for Weapons Systems Programs, Other represents spent nuclear fuel, which is used fuel removed from the nuclear reactors of nuclear powered ships and submarines. The estimate includes shipping, processing, and storing spent nuclear fuel.

|                                  |
|----------------------------------|
| <b>Environmental Disclosures</b> |
|----------------------------------|

| As of June 30  | 2007             | 2006             |
|--|------------------|------------------|
| A. The unrecognized portion of the estimated total cleanup costs associated with general property, plant, and equipment. | 1,625,238,185.92 | 1,423,683,246.76 |
| B. Changes in total cleanup costs due to changes in laws, regulations, and/or technology.                                | 0.00             | 0.00             |
| C. Portion of the changes in estimated costs due to changes in laws and technology that is related to prior periods.     | 0.00             | 0.00             |

Environmental Disclosures – Line A represents the unrecognized costs associated with General Property, Plant, and Equipment (PP&E). The unrecognized portion of the estimated total cleanup costs is associated with Non-Defense Environmental Restoration Program (DERP), such as nuclear-powered carriers and submarines, conventional ships, spent nuclear fuel, and landfills. The Department is implementing procedures to more accurately disclose the unrecognized portion of the estimated cleanup costs associated with General PP&E.

Environmental Disclosures – Line B represents the amount of changes in total cleanup costs due to changes in laws, regulations, and/or technology. The Department is unable to report this cost due to system and internal control weaknesses. The Department is implementing procedures in FY 2007 to more accurately disclose changes in total cleanup costs due to changes in laws, regulations, and/or technology.

Environmental Disclosures – Line C represents the portion of changes in estimated costs due to changes in laws and technology that is related to prior periods. The Department is unable to report this amount due to system and internal control weaknesses. The Department is implementing procedures in FY 2007 to more accurately disclose the amount of change in estimates for cost due to changes in laws and technology relating to prior periods.

## **Other Disclosures**

### Applicable Laws and Regulations for Cleanup Requirements

The Department is required to clean up contamination resulting from past waste disposal practices, leaks, spills, and other past activity that created a public health or environmental risk. The Department accomplishes this effort in coordination with regulatory agencies and, if applicable, other responsible parties and current property owners. The Department is also required to recognize closure and post-closure costs for its General 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 BRAC actions that have taken place.

The Department follows the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) and the Superfund Amendment and Reauthorization Act to clean up DERP-eligible contamination. Contamination clean up that is not eligible for DERP is performed in accordance with the Resource Conservation and Recovery Act (RCRA). The CERCLA and RCRA require the Department to clean up contamination in coordination with regulatory agencies, current owners of property damaged by the Department, and third parties that have a partial responsibility for the environmental restoration. Failure to comply with agreements and legal mandates will put the Department at risk of incurring fines and penalties.

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

The Chemical Weapons Disposal Program is based on FY 1986 National Defense Authorization Act (PL 99-145, as amended by subsequent acts) that directed the Department to destroy the unitary chemical stockpile by April 29, 2004. The current guidelines for destruction are based on the Chemical Weapons Convention treaty. The United States ratified the treaty in April 1997, requiring the stockpile of chemical weapons to be destroyed by April 2007, according to the terms outlined. The Army, as Executive Agent within the Department, provides policy, direction, and oversight for both the Chemical Stockpile Program and the Nonstockpile 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.

### Types of Environmental Liabilities and Disposal Liabilities Identified

The Department has clean-up requirements for DERP sites at active installations, BRAC installations, Formerly Used Defense Sites, sites at active installations that are not covered by DERP, weapon systems programs, and chemical weapons disposal programs. The weapons systems program consists of chemical weapons disposal, nuclear powered aircraft carriers, nuclear powered submarines, and other nuclear ships. All clean-up is done in coordination with regulatory agencies, other responsible parties, and current property owners.

### Methods for Assigning Total Cleanup Costs to Current Operating Periods

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

Once the environmental cost estimates are complete, the Department complies with accounting standards to assign costs to current operating periods. The Department has already expensed the costs for cleanup associated with General PP&E placed into service prior to October 1, 1997, unless the costs are intended to be recovered through user charges. If the costs are recovered through user charges, then the Department expensed that portion of the asset that has passed since the General PP&E was placed into service and is systematically recognizing the remaining cost over the life of the assets.

For General PP&E placed into service after September 30, 1997, the Department expenses the associated environmental costs systematically over the life of the asset. The Department expenses the full cost to clean up contamination for Stewardship PP&E at the time the asset is placed into service.

The Department uses two methods for systematic recognition: physical capacity for operating landfills, and life expectancy in years for all other assets.

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

The Department had changes in estimates resulting from overlooked or previously unknown contaminants, reestimation based on different assumptions, and lessons learned. Environmental liabilities may change in the future due to changes in laws and regulation, changes in agreements with regulatory agencies, and advances in technology.

### Uncertainty Regarding the Accounting Estimates Used to Calculate the Reported Environmental Liabilities

The environmental liabilities for the Department are based on accounting estimates which require certain judgments and assumptions that are reasonable, based upon available information at the time the estimates are calculated. The actual results may materially vary from the accounting estimates if agreements with regulatory agencies require remediation to a different degree than anticipated when calculating the estimates. The liabilities can be further impacted if investigation of the environmental sites reveals contamination levels that differ from the estimate parameters.

The Department is uncertain regarding the extent of the liabilities at installations that are realigning or closing as a result of BRAC requirements. The Department is in the process of determining the extent of environmental liabilities at BRAC installations, in particular those liabilities associated with unexploded ordnance on training ranges.

The Army has a liability to take environmental restoration/corrective action for buried chemical munitions, and agents. The Army is unable to provide a reasonable estimate at this time, because the extent of the buried chemical munitions and agents is not known.

The USACE is unable to provide a complete estimate for the Formerly Utilized Sites Remedial Action Program. The USACE has studies on-going and will update its liabilities as it identifies additional liabilities.

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

|                 |                          |
|-----------------|--------------------------|
| <b>Note 15.</b> | <b>Other Liabilities</b> |
|-----------------|--------------------------|

| As of June 30                                       | 2007                        |                            |                             | 2006                        |
|---|-----------------------------|----------------------------|-----------------------------|-----------------------------|
|   | Current Liability           | Noncurrent Liability       | Total                       | Total                       |
| <b>1. Intragovernmental</b>                         |                             |                            |                             |                             |
| A. Advances from Others                             | \$ 292,864,506.35           | \$ 0.00                    | \$ 292,864,506.35           | \$ 321,280,103.59           |
| B. Deposit Funds and Suspense Account Liabilities   | 1,541,319,124.67            | 0.00                       | 1,541,319,124.67            | 1,555,497,165.22            |
| C. Disbursing Officer Cash                          | 2,688,503,855.67            | 0.00                       | 2,688,503,855.67            | 2,114,678,414.83            |
| D. Judgment Fund Liabilities                        | 165,484,728.16              | 0.00                       | 165,484,728.16              | 164,049,146.59              |
| E. FECA Reimbursement to the Department of Labor    | 582,809,351.81              | 694,017,782.48             | 1,276,827,134.29            | 1,280,179,050.68            |
| F. Other Liabilities                                | 5,129,402,128.19            | 1,582,084,907.05           | 6,711,487,035.24            | 6,772,452,678.82            |
| <b>G. Total Intragovernmental Other Liabilities</b> | <b>\$ 10,400,383,694.85</b> | <b>\$ 2,276,102,689.53</b> | <b>\$ 12,676,486,384.38</b> | <b>\$ 12,208,136,559.73</b> |
| <b>2. Nonfederal</b>                                |                             |                            |                             |                             |
| A. Accrued Funded Payroll and Benefits              | \$ 4,728,966,974.89         | \$ 0.00                    | \$ 4,728,966,974.89         | \$ 7,834,109,434.45         |
| B. Advances from Others                             | 33,510,056,687.69           | 0.00                       | 33,510,056,687.69           | 2,008,998,028.84            |
| C. Deferred Credits                                 | 0.00                        | 0.00                       | 0.00                        | 11,800,000.00               |
| D. Deposit Funds and Suspense Accounts              | 177,498,908.65              | 0.00                       | 177,498,908.65              | 322,826,247.96              |
| E. Temporary Early Retirement Authority             | 0.00                        | 0.00                       | 0.00                        | 132,921.05                  |
| F. Nonenvironmental Disposal Liabilities            |                             |                            |                             |                             |
| (1) Military Equipment (Nonnuclear)                 | 9,711,990.47                | 246,980,097.99             | 256,692,088.46              | 124,626,646.23              |
| (2) Excess/Obsolete Structures                      | 59,412,000.00               | 626,206,000.00             | 685,618,000.00              | 235,897,000.00              |
| (3) Conventional Munitions Disposal                 | 0.00                        | 1,354,509,002.56           | 1,354,509,002.56            | 1,180,676,053.96            |
| G. Accrued Unfunded Annual Leave                    | 9,160,854,618.30            | 0.00                       | 9,160,854,618.30            | 8,439,603,342.50            |
| H. Capital Lease Liability                          | 16,348,536.66               | 170,422,939.67             | 186,771,476.33              | 240,523,975.01              |
| I. Other Liabilities                                | 6,111,481,122.35            | 3,606,954,589.92           | 9,718,435,712.27            | 10,114,396,019.98           |
| <b>J. Total Nonfederal Other Liabilities</b>        | <b>\$ 53,774,330,839.01</b> | <b>\$ 6,005,072,630.14</b> | <b>\$ 59,779,403,469.15</b> | <b>\$ 30,513,589,669.98</b> |
| <b>3. Total Other Liabilities</b>                   | <b>\$ 64,174,714,533.86</b> | <b>\$ 8,281,175,319.67</b> | <b>\$ 72,455,889,853.53</b> | <b>\$ 42,721,726,229.71</b> |

Intragovernmental Other Liabilities are comprised of approximately \$6.3 billion in custodial liabilities from accounts receivable for cancelled appropriations and interest, penalties, fines, and administrative fees from the public. The amounts collected cannot be used by the Department and must be distributed to the U.S. Treasury. There are certain entity accounts receivable associated with cancelled year accounts that once collected the Department has specific statutory authority to retain and remain as entity assets.

Nonfederal Other Liabilities consist of approximately: (1) \$5.0 billion in contingencies, of which \$1.8 billion consists of contract financing payments; (2) \$2.6 billion in accrued liabilities for contractual services; and (3) \$1.2 billion in employer contributions and payroll taxes payable.

Contingent Liabilities includes \$1.8 billion in estimated future contract financing payments that will be paid contractors upon delivery and Government acceptance. In accordance with contract terms, specific rights to the contractor's work vests with the Government when a specific type of contract financing payment is made. This action protects taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as rights of ownership. The Department is under no obligation to pay the contractor for amounts greater than the amounts authorized in the contract until delivery and Government acceptance. Because it is probable that the contractor will complete its efforts and deliver a satisfactory product to the Department and the amount of potential future payments are estimable, the Department has recognized a contingent liability for estimated future payments, which are conditional pending delivery and Government acceptance.

The Department has delinquent Federal Employment Compensation Act bills for 3<sup>rd</sup> Quarter, FY 2007, totaling \$19.7 million. The Army General Fund, Tricare Management Agency, and Defense Human Resources Agency owe the delinquency and expect to pay the remainder of the balance during 4<sup>th</sup> Quarter, FY 2007.

|                                |
|--------------------------------|
| <b>Capital Lease Liability</b> |
|--------------------------------|

| As of June 30  | 2007               |                 |         |                   | 2006              |
|--|--------------------|-----------------|---------|-------------------|-------------------|
|  | Asset Category     |                 |         |                   |                   |
|  | Land and Buildings | Equipment       | Other   | Total             | Total             |
| <b>1. Future Payments Due</b>  |                    |                 |         |                   |                   |
| A. 2007  | \$ 12,085,697.62   | \$ 2,534,828.74 | \$ 0.00 | \$ 14,620,526.36  | \$ 18,390,076.96  |
| B. 2008  | 47,123,104.55      | 155,951.00      | 0.00    | 47,279,055.55     | 61,533,319.52     |
| C. 2009  | 43,853,305.76      | 93,058.00       | 0.00    | 43,946,363.76     | 50,240,611.48     |
| D. 2010  | 43,853,305.76      | 0.00            | 0.00    | 43,853,305.76     | 43,946,363.76     |
| E. 2011  | 41,295,407.67      | 0.00            | 0.00    | 41,295,407.67     | 43,853,305.76     |
| F. 2012  | 13,087,621.97      | 0.00            | 0.00    | 13,087,621.97     | 0.00              |
| G. After 5 Years   | 31,011,160.44      | 0.00            | 0.00    | 31,011,160.44     | 44,098,782.43     |
| H. Total Future Lease Payments Due                                     | \$ 232,309,603.77  | \$ 2,783,837.74 | \$ 0.00 | \$ 235,093,441.51 | \$ 262,062,459.91 |
| I. Less: Imputed Interest Executory Costs                              | 48,254,960.81      | 67,004.37       | 0.00    | 48,321,965.18     | 62,833,892.58     |
| J. Net Capital Lease Liability   | \$ 184,054,642.96  | \$ 2,716,833.37 | \$ 0.00 | \$ 186,771,476.33 | \$ 199,228,567.33 |
| <b>2. Capital Lease Liabilities Covered by Budgetary Resources</b>     |                    |                 |         | \$ 154,269,307.60 | \$ 191,757,528.90 |
| <b>3. Capital Lease Liabilities Not Covered by Budgetary Resources</b> |                    |                 |         | \$ 32,502,168.73  | \$ 48,766,446.11  |

All leases entered into prior to FY 1992 are funded on an annual basis and subject to the availability of funds. Noncurrent amounts for these leases are shown as not covered by budgetary resources.

|                 |                                      |
|-----------------|--------------------------------------|
| <b>Note 16.</b> | <b>Commitments and Contingencies</b> |
|-----------------|--------------------------------------|

**Legal Contingencies**

The Department is a party in various administrative proceedings and legal actions, with claims including environmental damage claims, equal opportunity matters, and contractual bid protests. The Department has accrued contingent liabilities for legal actions where our Office of General Counsel (OGC) considers an adverse decision probable and the amount of loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Judgment Fund. The Department records Judgment Fund liabilities in Note 12, "Accounts Payable," and Note 15, "Other Liabilities."

The OGC reassesses legal cases annually at end of the FY. In FY 2006, the Department reported 65 legal actions with individual claims greater than the Department-wide materiality threshold for reporting litigation, claims, or assessments of \$107.6 million. Management determined that claims totaling approximately \$484.2 billion had a remote probability of an adverse decision against the Department. The Department also had a number of potential claims that individually did not meet the \$107.6 million threshold materiality at the Department-wide level, but did meet individual Department Component thresholds. These claims should be disclosed in the Components' financial statements.

The materiality threshold for FY 2007 has been determined to be \$110.5 million per individual case. The Department is currently assessing cases meeting that threshold for FY 2007 year end reporting.

**Other Commitments and Contingencies**

Undelivered orders for open (unfilled or unreconciled) contracts citing cancelled appropriations, for which the Department may incur a contractual commitment for payment, total \$1.1 billion.

The Department has made contractual arrangements for award fees and incentives on contracts which will require future financial obligations if contract terms are satisfied.

|                 |  |
|-----------------|--|
| <b>Note 17.</b> | <b>Military Retirement and Other Federal Employment Benefits</b> |
|-----------------|--|

| As of June 30  | 2007                      |                           |  |                         | 2006                      |
|--|---------------------------|---------------------------|--|-------------------------|---------------------------|
|  | Present Value of Benefits | Assumed Interest Rate (%) | (Less: Assets Available to Pay Benefits) | Unfunded Liability      | Present Value of Benefits |
| <b>1. Pension and Health Actuarial Benefits</b>                            |                           |                           |  |                         |                           |
| A. Military Retirement Pensions  | \$ 963,696,276,612.06     | 6.0                       | \$ (220,275,229,915.75)                  | \$ 743,421,046,696.31   | \$ 892,111,600,551.72     |
| B. Military Retirement Health Benefits                                     | 299,203,802,000.00        | 6.25                      | 0.00                                     | 299,203,802,000.00      | 296,473,202,000.00        |
| C. Military Medicare-Eligible Retiree Benefits                             | 538,032,547,000.00        | 6.25                      | (110,143,222,556.51)                     | 427,889,324,443.49      | 537,397,092,000.00        |
| D. Total Pension and Health Actuarial Benefits                             | \$ 1,800,932,625,612.10   |                           | \$ (330,418,452,472.26)                  | \$ 1,470,514,173,139.80 | \$ 1,725,981,894,551.70   |
| <b>2. Other Actuarial Benefits</b>   |                           |                           |  |                         |                           |
| A. FECA  | \$ 6,855,989,000.01       | 5.17                      | \$ 0.00                                  | \$ 6,855,989,000.01     | \$ 6,918,880,749.76       |
| B. Voluntary Separation Incentive Programs                                 | 1,391,124,000.00          | 4.0                       | (679,736,794.52)                         | 711,387,205.48          | 1,495,755,463.00          |
| C. DoD Education Benefits Fund   | 1,785,339,161.00          | 5.0                       | (1,473,185,403.89)                       | 312,153,757.11          | 1,661,351,399.01          |
| D. Total Other Actuarial Benefits  | \$ 10,032,452,161.01      |                           | \$ (2,152,922,198.41)                    | \$ 7,879,529,962.60     | \$ 10,075,987,611.77      |
| <b>3. Other Federal Employment Benefits</b>                                | \$ 5,561,958,875.98       |                           | \$ (4,152,461,788.66)                    | \$ 1,409,497,087.32     | \$ 0.00                   |
| <b>4. Total Military Retirement and Other Federal Employment Benefits:</b> | \$ 1,816,527,036,649.10   |                           | \$ (336,723,836,459.33)                  | \$ 1,479,803,200,189.70 | \$ 1,736,057,882,163.50   |

Actuarial Cost Method Used: Aggregate entry-age method

Assumptions: See below

Market Value of Investments in Market-based and Marketable Securities: \$312.4 billion

**Military Retirement Pensions**

The Military Retirement Fund is a single-employer, defined benefit plan authorized by Public Law 98-94. Administrative costs of the Fund are not ascertainable. Projected revenues into the Fund come from three sources: 1) interest earnings on Fund assets, 2) monthly Department contributions, and 3) annual contributions from U. S. Treasury. The monthly Department contributions are determined as a percentage of basic pay as approved by the Department's Retirement Board of Actuaries. The annual contribution from U. S. 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 since arisen. Effective FY 2005, U. S. Treasury began making an annual contribution to the Fund that represents the normal cost amount for the concurrent receipt provisions of FY 2004 National Defense Authorization Act. The Board of Actuaries determine U. S. 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 Department's Retirement Board of Actuaries. The long-term assumptions for the FY 2005 valuation were 6.25% interest, 3.0% Consumer Price Index, and 3.75% salary increase. The long-term economic assumption for interest was lowered to 6.00% by the Board at its August 2006 meeting. 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 Department's Office of Actuary Valuation of the Military Retirement System. For purposes of the Fund's financial reporting, this process is applied annually. In calculating FY 2006 roll-forward amount, the following assumptions were used:

|                  | <u>Inflation</u> | <u>Salary</u>    | <u>Interest</u> |
|------------------|------------------|------------------|-----------------|
| Fiscal Year 2006 | 4.1% (actual)    | 3.1% (actual)    | 6.0%            |
| Fiscal Year 2007 | 3.0% (estimated) | 2.7% (estimated) | 6.0%            |
| Long-Term        | 3.0%             | 3.75%            | 6.0%            |

**Change in MRF Actuarial Liability**

(Amounts in billions)

|  |                |
|--|----------------|
| Actuarial Liability as of 9/30/05                            | \$892.1        |
| Expected Normal Cost for FY 2006                             | 15.5           |
| Plan Amendment Liability                                     | 0.1            |
| Assumption Change Liability                                  | 35.4           |
| Expected Benefit Payments for FY 2006                        | (40.5)         |
| Interest Cost for FY 2006                                    | 55.0           |
| Actuarial (gains)/losses due to changes in trend assumptions | <u>6.1</u>     |
| Actuarial Liability as of 09/30/06                           | <u>\$963.7</u> |
| Change in Actuarial Liability                                | <u>\$71.6</u>  |

Actuarial Cost Method Used: Aggregate entry-age normal method.

Market Value of Investments in Market-Based and Marketable Securities: \$211.5 billion

Assumed Interest Rate: 6%

The actuarial liability reported above does not include \$3.5 billion in incurred but not reported liabilities as of June 30, 2007. These liabilities are reflected in Other Federal Employment Benefits on the schedule under Assets Available to Pay Benefits.

**Military Retirement Health Benefits (MRHB)**

The MRHB are post-retirement benefits the Department provides to non-Medicare-eligible military retirees and other eligible beneficiaries who are not Medicare-eligible, through private sector health care providers and Department Medical Treatment Facilities.

**Change in MRHB Actuarial Liability**

(Amounts in billions)

|   |                |
|---|----------------|
| Actuarial Liability as of 09/30/05 (Department preMedicare + all uniformed services Medicare cost-basis effect) | \$296.5        |
| Expected Normal Cost for FY 2006  | 10.0           |
| Expected Benefit Payments for FY 2006   | (9.3)          |
| Interest Cost for FY 2006   | 18.9           |
| Actuarial (gains)/losses due to other factors   | 39.4           |
| Actuarial (gains)/losses due to changes in trend assumptions  | <u>(56.3)</u>  |
| Actuarial Liability as of 09/30/06 (Department preMedicare + all uniformed services Medicare cost-basis effect) | <u>\$299.2</u> |
| Change in Actuarial Liability   | <u>\$ 2.7</u>  |

Actuarial Cost Method Used: Aggregate Entry-Age Normal Method

Assumed Interest Rate: 6.25%

| <b>Medical Trend</b>                         | <b>FY 2005 – FY 2006</b> | <b>Ultimate Rate - 2030</b> |
|--|--------------------------|-----------------------------|
| Medicare Inpatient:                          | 5.62%                    | 6.25%                       |
| Medicare Outpatient:                         | 7.83%                    | 6.25%                       |
| Medicare Prescriptions (Direct Care):        | 8.13%                    | 6.25%                       |
| Medicare Prescriptions (Purchased Care)      | 11.22%                   | 6.25%                       |
| Non-Medicare Inpatient (Direct Care):        | 7.50%                    | 6.25%                       |
| Non-Medicare Outpatient (Direct Care):       | 4.00%                    | 6.25%                       |
| Non-Medicare Prescriptions (Direct Care):    | 7.00%                    | 6.25%                       |
| Non-Medicare Inpatient (Purchased Care):     | 10.40%                   | 6.25%                       |
| Non-Medicare Outpatient (Purchased Care):    | 7.40%                    | 6.25%                       |
| Non-Medicare Prescriptions (Purchased Care): | 12.11%                   | 6.25%                       |

### Other Information

The MRHB liability represents the Department's preMedicare liabilities for direct care and purchase care benefits, plus the direct-care cost-basis effect for Medicare liabilities for all Uniformed Services. The cost-basis effect is approximately \$28.0 billion as of September 30, 2006, and arises because liabilities for direct care in the total retiree health liability are valued at a higher cost basis than they are in the Medicare Eligible Retiree Health Care Fund (MERHCF) liability. The \$299.2 billion liability includes \$298.5 billion for the Department, \$600.0 million for the Coast Guard, \$69.8 million for the Public Health Service and \$4.6 million for the National Oceanic and Atmospheric Administration (NOAA). For purposes of the Fund's financial reporting, the liability is calculated annually.

The actuarial liability reported above does not include \$1.4 billion in incurred but not reported liabilities as of June 30, 2007. These liabilities are reflected in Other Federal Employment Benefits on the schedule.

### **Military Medicare-Eligible Retiree Benefits**

Public Law 106-398 authorized the establishment of MERHCF for the purpose of accumulating funds to finance the health care program liabilities of Medicare-eligible retirees for all the Uniformed Services and specific Medicare-eligible beneficiaries beginning operations October 1, 2002. Projected revenues into MERHCF, authorized by Chapter 56 of Title 10, United States Code, come from three sources: interest earnings on Fund assets, annual Uniformed Services normal cost contributions, and annual contributions from the U. S. Treasury. Prior to October 1, 2005, the normal cost contributions by the Services were paid monthly at per capita amount times actual end strength as approved by the Department's Board of Actuaries. Beginning in FY 2006, the normal cost is paid annually at the beginning of the fiscal year by U. S. Treasury, from amounts appropriated to the Military Services, and is calculated at the approved rate times the budgeted force strengths. The contribution from U. S. Treasury is also paid into the Fund at the beginning of each fiscal year and represents the amortization of the unfunded liability for services performed prior to October 1, 2002, as well as the amortization of actuarial gains and losses that have since arisen. The Department's Board of Actuaries determines U. S. Treasury's contribution, and the Secretary of Defense directs the Secretary of Treasury to make the payment.

Assumptions used to calculate the actuarial liabilities, such as mortality and retirement rates, were based on actual experience. Claim 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. 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. In calculating the FY 2006 roll-forward amount, the following medical trend assumptions were used:

| <b>Medical Trend</b>                     | <b>FY 2005 - FY 2006</b> | <b>Ultimate Rate - 2030</b> |
|--|--------------------------|-----------------------------|
| Medicare Inpatient:                      | 5.62%                    | 6.25%                       |
| Medicare Outpatient:                     | 7.83%                    | 6.25%                       |
| Medicare Prescriptions (Direct Care):    | 8.13%                    | 6.25%                       |
| Medicare Prescriptions (Purchased Care): | 11.22%                   | 6.25%                       |

## Changes in MERHCF Actuarial Liability

|  | (Amounts in billions) |
|--|-----------------------|
| Actuarial Liability as of 09/30/05 (all uniformed services Medicare) | \$537.4               |
| Expected Normal Cost for FY 2006                                     | 11.0                  |
| Expected Benefit Payments for FY 2006                                | (7.5)                 |
| Interest Cost for FY 2006  | 34.1                  |
| Actuarial (gains)/losses due to other factors                        | 42.1                  |
| Actuarial (gains)/losses due to changes in trend assumptions         | (79.1)                |
| Actuarial Liability as of 09/30/06 (all uniformed services Medicare) | <u>\$538.0</u>        |
| Change in Actuarial Liability  | <u>\$0.6</u>          |

Actuarial Cost Method Used for MERHCF Liability: Aggregate Entry-Age Normal  
Market Value of Investments in Market-Based and Marketable Securities: \$103.4 billion  
Assumed Interest Rate: 6.25%

The MERHCF liability includes Medicare liabilities for all Uniformed Services. The \$538.0 billion liability includes \$526.3 billion for the Department, \$10.5 billion for the Coast Guard, \$1.1 billion for the Public Health Service and \$100.0 million for NOAA. The FY 2006 contributions from each of the services were: \$10.8 billion by the Department, \$300.0 million by the Coast Guard, \$34.5 million by the Public Health Service, and \$1.6 million by NOAA.

The actuarial liability reported above does not include \$602.2 million in incurred but not reported liabilities as of June 30, 2007. These liabilities are reflected in Other Federal Employment Benefits on the schedule under Assets Available to Pay Benefits.

## Federal Employees Compensation Act (FECA)

### Assumptions

The liability for future workers' compensation benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined annually using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the Office of Management and Budget's economic assumptions for 10-year U. S. Treasury notes and bonds. A 5.17% interest rate was assumed in year one and 5.31% were assumed in year two and thereafter.

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

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

| <u>CBY</u> | <u>COLA</u> | <u>CPIM</u> |
|------------|-------------|-------------|
| 2006       | 3.50%       | 4.00%       |
| 2007       | 3.13%       | 4.01%       |
| 2008       | 2.40%       | 4.01%       |
| 2009       | 2.40%       | 4.01%       |
| 2010       | 2.43%       | 4.09%       |

The model's resulting projections were analyzed to ensure that the estimates were reliable. The analysis was based on four tests: (1) a sensitivity analysis of the model of economic assumptions, (2) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual payments, (3) a comparison of the incremental paid losses (the medical component in particular) in CBY 2006 (by injury cohort) to the average pattern observed during the prior three charge back years, and (4) a comparison of the ratio of the estimated liability to the actual payment of the beginning year calculated for the current projection to the liability-payment ratio calculated for the prior projection.

## **Voluntary Separation Incentive Programs (VSI)**

### Assumptions

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% of the person's annual basic pay at the time they departed service multiplied by the number of years of service. The September 30, 2006, VSI Actuarial Present Value of Projected Plan Benefits (Actuarial Liability) was calculated at an assumed annual interest rate of 4%. Since VSI program is no longer offered each year the Actuarial Liability is expected to decrease with benefit outlays, and increase with interest cost. The present value of plan benefits actuarial liability for the VSI fund is \$1.4 billion as of September 30, 2006. The liability is calculated annually at the present value of all remaining payments as of September 30, 2006.

Market Value of Investments in Market-based and Marketable Securities: \$620.9 million

## **DoD Education Benefits Fund (EBF)**

### Assumptions

The EBF 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. The actuarial liability is calculated annually at an assumed interest rate of 5% and has a present value of \$1.8 billion as of September 30, 2006.

Market Value of Investments in Market-based and Marketable Securities: \$1.3 billion

## **Other Federal Employment Benefits**

The format of this note was changed in FY 2006 to include Other Federal Employment Benefits, such as pension and other post-employment benefits due and payable, which were previously included in Note 15.

**Note 18.****General Disclosures Related to the Statement of Net Cost****Intragovernmental Costs and Exchange Revenue**

As of June 30

|                                     | 2007                          | 2006                          |
|-------------------------------------|-------------------------------|-------------------------------|
| 1. Intragovernmental Costs          | \$ 18,553,738,049.82          | \$ 18,901,195,476.09          |
| 2. Public Costs                     | 425,933,621,500.72            | 400,456,400,970.43            |
| <b>3. Total Costs</b>               | <b>\$ 444,487,359,550.54</b>  | <b>\$ 419,357,596,446.52</b>  |
| 4. Intragovernmental Earned Revenue | \$ (14,883,787,777.55)        | \$ (18,954,692,827.05)        |
| 5. Public Earned Revenue            | (20,165,712,556.87)           | (17,447,922,778.21)           |
| <b>6. Total Earned Revenue</b>      | <b>\$ (35,049,500,334.42)</b> | <b>\$ (36,402,615,605.26)</b> |
| <b>7. Net Cost of Operations</b>    | <b>\$ 409,437,859,216.12</b>  | <b>\$ 382,954,980,841.26</b>  |

The Statement of Net Cost (SNC) is unique because its principles are driven on understanding the net cost of programs and/or organizations that the Federal Government supports through appropriations or other means. This statement provides gross and net cost information that can be related to the amount of output or outcome for a given program and/or organization administered by a responsible reporting entity. Intragovernmental costs and revenue are related to transactions made between two reporting entities within the Federal Government. Public costs and revenues are exchange transactions made between the reporting entity and a nonfederal entity.

For General Funds, the amounts are based on obligations and disbursements and therefore may not, in all cases, accrue actual costs. While the Department's Working Capital Funds generally record transactions on an accrual basis, the systems do not always capture actual costs in a timely manner. As such, information presented in SNC is based on budgetary obligations, disbursements, and collection transactions, as well as nonfinancial feeder systems adjusted to record known accruals for major items such as payroll expenses, accounts payable and environmental liabilities.

The majority of the Department's accounting systems do not capture information relative to heritage assets separately and distinctly from normal operations. Where it was able to separately identify the cost of acquiring, constructing, improving, reconstructing or renovating heritage assets, the Department has identified \$1.1 million for the fiscal year.

|                 |  |
|-----------------|--|
| <b>Note 19.</b> | <b>Disclosures Related to the Statement of Changes in Net Position</b> |
|-----------------|--|

| As of June 30  | 2007                                |                              | 2006                                |                              |
|--|-------------------------------------|------------------------------|-------------------------------------|------------------------------|
|  | Cumulative Results<br>of Operations | Unexpended<br>Appropriations | Cumulative Results<br>of Operations | Unexpended<br>Appropriations |
| <b>1. Prior Period Adjustments</b>                             |                                     |                              |                                     |                              |
| <b>Increases (Decreases) to Net Position Beginning Balance</b> |                                     |                              |                                     |                              |
| A. Changes in Accounting Standards                             | \$ 0.00                             | \$ 0.00                      | \$ 0.00                             | \$ 0.00                      |
| B. Errors and Omissions in Prior Year Accounting Reports       | 0.00                                | 0.00                         | (21,833,207,720.24)                 | (527,457.36)                 |
| <b>C. Total Prior Period Adjustments</b>                       | <b>\$ 0.00</b>                      | <b>\$ 0.00</b>               | <b>\$ (21,833,207,720.24)</b>       | <b>\$ (527,457.36)</b>       |
| <b>2. Imputed Financing</b>                                    |                                     |                              |                                     |                              |
| A. Civilian CSRS/FERS Retirement                               | \$ 1,017,796,361.56                 | \$ 0.00                      | \$ 1,126,666,272.38                 | \$ 0.00                      |
| B. Civilian Health   | 2,053,619,453.54                    | 0.00                         | 1,941,133,633.19                    | 0.00                         |
| C. Civilian Life Insurance                                     | 5,836,176.47                        | 0.00                         | 18,846,958.04                       | 0.00                         |
| D. Judgment Fund   | 108,544,504.98                      | 0.00                         | 112,431,487.78                      | 0.00                         |
| E. IntraEntity   | 0.00                                | 0.00                         | 0.00                                | 0.00                         |
| <b>F. Total Imputed Financing</b>                              | <b>\$ 3,185,796,496.55</b>          | <b>\$ 0.00</b>               | <b>\$ 3,199,078,351.39</b>          | <b>\$ 0.00</b>               |

The prior period adjustment (PPA) of \$21.8 billion recorded in 3rd Quarter, FY 2006, restated the cumulative results of operations for the revaluation of military equipment. An additional adjustment made in 4th Quarter, FY 2006, reduced the PPA by \$13.7 billion, resulting in total FY 2006 net PPAs of \$8.1 billion for military equipment revaluation. The net ending FY 2006 PPA (\$8.1 billion) is included in the beginning net position for FY 2007, but the 4th quarter PPA (\$13.7 billion) is not presented in the 3rd Quarter, FY 2006 comparative column in the table above. Due to system shortcomings, comparable quarterly data prior to the quarter in which PPAs are originally made are not restated.

The amounts the Department of Defense remits to the Office of Personnel Management (OPM) by and for employees covered by the Civil Service Retirement System, the Federal Employees' Retirement System, the Federal Employees' Health Benefits program, and the Federal Employees' Group Life Insurance program do not fully cover the government's cost to provide these benefits. An imputed cost is recognized as the difference between the government's cost of providing these benefits to employees and the Department's contributions. The OPM provides cost factors for the computation of imputed financing costs, and these estimates are included in the Department's financial statements.

Budgetary Financing Sources, Other for (\$733.8) million is wholly attributable to losses on disposition of assets.

Other Financing Sources, Other for (\$11.3) billion consists primarily of adjustments to reconcile budgetary and proprietary trial balances. Due to the Department's financial system limitations, unreconciled differences exist between the budgetary and proprietary trial balances. The net effect of these adjustments to correct this deficiency is reflected on the Other Financing Sources, Other line on the Statement of Changes in Net Position (SCNP).

Unexpended Appropriations, Budgetary Financing Sources, Other adjustments is comprised of rescissions, capital transfers, and cancellations of expired appropriations, to the original appropriation authority given to the Department.

In the SCNP, all offsetting balances (i.e. transfers-in and transfers out, revenues, and expenses) for intraDepartment activity between earmarked and other (non earmarked) funds are reported on the same lines. This results in an eliminations column, which appears to contain no balances.

In reality, the column contains all appropriate elimination entries, but all net to zero within each respective line, except for intraentity imputed financing costs.

Earmarked Cumulative Results of Operations ending balance on the SCNP does not agree with the Earmarked Cumulative Results reported on the Balance Sheet because the cumulative results on the Balance Sheet are presented net of eliminations.

There is an \$86.0 billion difference between Appropriations Received that are reported on SCNP (\$659.2 billion) and Appropriations Received in the Statement of Budgetary Resources (\$745.2 billion). This difference is primarily due to appropriations transferred to the trust and special funds which are duplicated in accordance with Office of Management and Budget guidance for the Statement of Budgetary Resources. In addition, a small portion of the differences relates to interest collected by the trust funds. See Note 20, "Disclosures Related to the Statement of Budgetary Resources," for additional information.

|                 |  |
|-----------------|--|
| <b>Note 20.</b> | <b>Disclosures Related to the Statement of Budgetary Resources</b> |
|-----------------|--|

| As of June 30  | 2007                  | 2006                  |
|--|-----------------------|-----------------------|
| 1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period | \$ 331,344,078,734.57 | \$ 288,343,841,372.99 |
| 2. Available Borrowing and Contract Authority at the End of the Period                         | 69,949,572,874.10     | 48,599,068,531.93     |

**Reconciliation Differences**

There is a difference of \$14.5 billion between the Borrowing and Contract Authority reported in the table above (\$69.9 billion) and the amount reported for Available Borrowing and Contract Authority on the Statement of Budgetary Resources (SBR) (\$84.4 billion). The table above reports current year activity as well as carry forward amounts for both categories of authority. The SBR only reports current year activity for these categories.

Appropriations Received on the SBR exceed Appropriations Received on the Statement of Changes in Net Position by \$86.0 billion. In accordance with Office of Management and Budget (OMB) guidance, appropriations received by the Military Departments and Defense Agencies are subsequently recognized a second time on the SBR as appropriations transferred into trust and special funds and comprise \$66.6 billion. Actual and anticipated earnings in trust and special funds comprise the balance of the difference.

**Permanent Indefinite Appropriations**

The Department of Defense (DoD) 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 6971B)
- Burdensharing Contributions Account (10 USC 2350(j))
- Forest Program (10 USC 2665)
- Department of Defense Base Closure Account (10 USC 2687)
- Medicare Eligible Retiree Health Care Fund (MERHCF) (10 USC 1111)
- Military Retirement Fund (MRF) (10 USC 1461)
- Education Benefits Fund (10 USC 2006)
- Reserve Mobilization Income Insurance Fund (10 USC 12528)
- Host Nation Support for U.S. Relocation Activities (10 USC 2350(k))
- National Defense Sealift Fund (10 USC 2218)
- Environmental Restoration, Navy (10 USC 2702)
- Hydraulic Mining Debris Reservoir (33 USC 683)
- Maintenance and Operation of Dams and Other Improvements of Navigable Waters (16 USC 810(a))
- Payments to States (33 USC 701c-3)
- Wildlife Conservation (16 USC 670-670(f))
- Ainsworth Bequest (31 USC 1321)
- Department of Defense Family Housing Improvement Fund (10 USC 2883 (a))
- Department of Defense Military Unaccompanied Housing Improvement Fund (10 USC 2883 (a))

The above permanent indefinite appropriations cover a wide variety of purposes to help the Department accomplish its missions. These purposes include: (1) military retirees healthcare benefits, retirement and survivor pay, and education benefits for veterans; (2) environmental, coastal, and wildlife habitat restoration, and water resources maintenance; (3) costs associated with the closure or realignment of military installations; (4) relocation of armed forces to a host nation; (5) separation payments for foreign nationals; (6) the construction, purchase, alteration, and conversion of sealift vessels; and (7) upkeep of libraries and museums. See Note 23 for additional information on those funds that are earmarked.

In addition to the above, the Executive Office of the President has given the Department authority to execute the funds listed below on its behalf:

- Special Defense Acquisition Fund (22 USC 2795)
- Foreign Military Loans Liquidating Account (22 USC 2764)
- Foreign Military Financing, Direct Loan Financing Account (2 USC 661 (d))
- Military Debt Reduction Financing Account (2 USC 661 (d))
- Advances, Foreign Military Sales (22 USC 2761-2762)

### **Apportionment Categories for Obligations**

The Department reported the following amounts of direct obligations: (1) \$383.3 billion in category A; (2) \$125.0 billion in category B; and (3) \$32.7 billion in exempt from apportionment. The Department reported the following amounts of reimbursable obligations: (1) \$66.7 billion in category A; (2) \$47.2 billion in category B; and (3) \$6.0 million in exempt from apportionment. Category A relates to appropriations for a specific period of time (e.g., Military Personnel appropriation), and category B relates to appropriations for a specific project (e.g., Military Construction appropriation).

### **Other Disclosures**

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

The Department utilizes borrowing authority for the Military Housing Privatization, the Armament Retooling and Manufacturing Support Initiatives and for the Foreign Military Financing Direct Loan and Debt Reduction Financing Accounts. Borrowing authority is used in accordance with OMB Circular A-129, "Managing Federal Credit Programs."

The Department operates within the constraints of fiscal law and has no additional legal arrangements affecting the use of unobligated balances.

The Department received additional funding of \$70.0 billion to replenish expenses incurred outside of normal operating expenses. The Department also received an additional \$99.4 billion during the 3rd quarter, FY 2007 primarily for U.S. Troop Readiness, Veterans' Care, and Katrina Recovery.

The Department has a \$2.9 billion difference between the SF-133, "Report on Budget Execution and Budgetary Resources," and the Statement of Budgetary Resources. The difference is due to presentational differences between the two reports for anticipated reimbursements and other income at the respective reporting level.

The Department reported a change in unobligated balances brought forward of \$1.0 billion due to the requirement of OMB Circular A-136, "Financial Reporting Requirements." See Notes 1 and 3 for details.

|                 |  |
|-----------------|--|
| <b>Note 21.</b> | <b>Disclosures Related to the Statement of Financing</b> |
|-----------------|--|

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

|  |                     |
|--|---------------------|
| Resources That Finance the Acquisition of Assets               | \$ 17,488.6 million |
| Other - Other Components Not Requiring or Generating Resources | \$ 28.9 million     |

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

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

Other Resources – Other for (\$11.3) billion and Other Resources or Adjustments to Net Obligated Resources that Do Not Affect Net Cost of Operations – Other for \$11.3 billion consist primarily of nonexchange gains and losses necessary to reconcile the proprietary and budgetary accounts.

Components Requiring or Generating Resources in Future Period - Other for \$4.2 billion consists primarily of future funded expenses for potential contingent legal liability estimates and employee related liabilities.

Components not Requiring or Generating Resources - Other for (\$27.0) billion consists primarily of cost capitalization offsets, applied overhead for work in progress, bad debt expense and other expenses not requiring budgetary resources.

Liabilities not covered by budgetary resources on the Balance Sheet totaling \$1.6 trillion, decreased \$41.8 billion and differs from the amount reported as Components Requiring or Generating Resources in Future Periods on the Statement of Financing, which totals \$8.8 billion. The difference is primarily due to the differing perspectives between the two statements. Liabilities not covered by budgetary resources report the cumulative balance for Balance Sheet liabilities not yet funded whereas components requiring or generating resources in future periods reflects current period changes for unfunded environmental and disposal liabilities, annual leave, and other expenses not requiring budgetary resources. The remaining difference of \$33.0 billion primarily consists of decreases in future funded actuarial liabilities that were reported on the 4<sup>th</sup> quarter, FY 2006 Statement of Financing.

|                 |   |
|-----------------|---|
| <b>Note 22.</b> | <b>Disclosures Related to the Statement of Custodial Activity</b> |
|-----------------|---|

The Statement of Custodial Activity displays current year collections and disbursements for the Development Fund for Iraq (DFI) and Seized Assets. Funds held in a custodial activity are only used for the stated purposes and are not available for the Department's use.

**Development Fund for Iraq**

The DFI is for urgent humanitarian assistance, reconstruction, and other projects carried out for the benefit of the Iraqi people. During FY 2007, the Multi-National Force Iraq disbursed \$5.7 million, with no additional deposits. As of June 30, 2007, \$13.1 million remains to be disbursed.

|   | (Amounts in Millions)     |                                      |
|---|---------------------------|--------------------------------------|
|   | <b>During<br/>FY 2007</b> | <b>Cumulative<br/>from Inception</b> |
| <b>Source of Collections</b>                            |                           |                                      |
| Deposits By Foreign Governments                         | \$ 0.0                    | \$ 136.0                             |
| <b>Disposition of Collections</b>                       |                           |                                      |
| Security and Law Enforcement                            | \$ 0.0                    | \$ 1.0                               |
| Electric Sector   | (0.6)                     | 44.6                                 |
| Oil Infrastructure                                      | 0.0                       | .4                                   |
| Water Resources and Sanitation                          | 1.2                       | 17.8                                 |
| Transportation and Telecommunications                   | 0.3                       | 5.6                                  |
| Roads, Bridges and Construction                         | 0.0                       | 5.0                                  |
| Health Care   | 0.0                       | 2.9                                  |
| Private Sector Development                              | 0.0                       | 7.2                                  |
| Education, Refugees, Human Rights, and Governance       | 4.8                       | 38.4                                 |
| <b>Total Disbursed on Behalf of Foreign Governments</b> | 5.7                       | 122.9                                |
| Retained for Future Support of Foreign Governments *    | (5.7)                     | 13.1                                 |
| <b>Total Disposition of Collections</b>                 | \$ 0.0                    | \$ 136.0                             |
| <b>Net Custodial Collection Activity</b>                | \$ 0.0                    | \$ 0.0                               |

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

## Seized Assets

During Operation Iraqi Freedom, the U.S. Government seized assets from the Iraqi Government that are used in support of the Iraqi people. In FY 2007, the Department disbursed \$1.8 million, with no additional seized assets. As of June 30, 2007, \$28.4 million of seized monetary assets remain to be disbursed in support of the Iraqi people.

|  | (Amounts in Millions)     |                                      |
|--|---------------------------|--------------------------------------|
|  | <b>During<br/>FY 2007</b> | <b>Cumulative<br/>From Inception</b> |
| <b>Source of Collections</b>                                   |                           |                                      |
| Seized Iraqi Cash  | \$ 0.0                    | \$ 927.2                             |
| <b>Disposition of Collections</b>                              |                           |                                      |
| Iraqi Salaries   | \$ 0.0                    | \$ 30.8                              |
| Repair/Reconstruction/Humanitarian Assistance                  | 1.8                       | 528.0                                |
| Iraqi Ministry Operations (Ministry of Finance, Defense, etc.) | 0.0                       | 264.7                                |
| Fuel/Supplies  | 0.0                       | 75.3                                 |
| <b>Total Disbursed on Behalf of Iraqi People</b>               | 1.8                       | 898.8                                |
| Retained for Future Support of the Iraqi People                | (1.8)                     | 28.4                                 |
| <b>Total Disposition of Collections</b>                        | <u>\$ 0.0</u>             | <u>\$ 927.2</u>                      |
| <b>Net Custodial Collection Activity</b>                       | <u>\$ 0.0</u>             | <u>\$ 0.0</u>                        |

**Note 23.****Earmarked Funds****BALANCE SHEET**  
As of June 30, 2007

|                                  | Military Retirement Fund | Medicare Eligible Retiree Health Care Fund | Other Earmarked Funds       | Eliminations              | Total                        |
|----------------------------------|--------------------------|--|-----------------------------|---------------------------|------------------------------|
| <b>ASSETS</b>                    |                          |  |                             |                           |                              |
| Fund balance with Treasury       | \$ 46,444,378.38         | \$ 5,000,000.00                            | \$ 1,881,659,534.00         | \$ 0.00                   | \$ 1,933,103,912.38          |
|                                  | 222,809,452,842.2        | 110,157,377,007.8                          |                             |                           |                              |
| Investments                      | 0                        | 0  | 6,008,271,011.53            | 0.00                      | 338,975,100,861.53           |
| Accounts and Interest Receivable | 23,287,216.03            | 14,878,631.27                              | 783,267,739.38              | (26,050,831.83)           | 795,382,754.85               |
| Other Assets                     | 0.00                     | 0.00                                       | 1,893,478,230.92            | 0.00                      | 1,893,478,230.92             |
|                                  | 222,879,184,436.6        | 110,177,255,639.0                          |                             |                           |                              |
| <b>Total Assets</b>              | <b>\$ 1</b>              | <b>\$ 7</b>                                | <b>\$ 10,566,676,515.83</b> | <b>\$ (26,050,831.83)</b> | <b>\$ 343,597,065,759.68</b> |

**LIABILITIES and NET POSITION**

|  |                      |                      |                             |                             |                              |
|--|----------------------|----------------------|-----------------------------|-----------------------------|------------------------------|
| Military Retirement Benefits and Other Federal Employment Benefits | \$ 967,240,203,537.1 | \$ 538,634,752,000.0 | \$ 3,176,463,161.00         | \$ 0.00                     | \$ 1,509,051,418,698.1       |
|  | 2                    | 0                    |                             |                             | 0                            |
| Other Liabilities  | 941,837.24           | 234,123,623.27       | 1,256,161,727.82            | (80,561,639.73)             | 1,410,665,548.60             |
|  | 967,241,145,374.3    | 538,868,875,623.2    |                             |                             | 1,510,462,084,246.7          |
| <b>Total Liabilities</b>   | <b>\$ 6</b>          | <b>\$ 7</b>          | <b>\$ 4,432,624,888.82</b>  | <b>\$ (80,561,639.73)</b>   | <b>\$ 0</b>                  |
|  |                      |                      |                             |                             |                              |
| Unexpended Appropriations  | 0.00                 | 0.00                 | 9,606,486.21                | 0.00                        | 9,606,486.21                 |
| Cumulative Results of Operations                                   | (744,361,960,937.7   | (428,691,619,984.2   | 6,124,445,140.80            | (64,802,949,752.3           | (1,231,732,085,533.50)       |
|  | 5)                   | 0)                   |                             | 6)                          | 50)                          |
| <b>Total Liabilities and Net Position</b>                          | <b>\$ 1</b>          | <b>\$ 7</b>          | <b>\$ 10,566,676,515.83</b> | <b>\$ (64,883,511,392.0</b> | <b>\$ 278,739,605,199.41</b> |

**STATEMENT OF NET COST**

For the period ended June 30, 2007

|   |                      |                     |                            |                      |                             |
|---|----------------------|---------------------|----------------------------|----------------------|-----------------------------|
| Program Costs                                     | \$ 32,574,218,590.24 | \$ 5,705,430,057.47 | \$ 2,226,432,580.70        | \$ (1,939,190,095.13 | \$ 38,566,891,133.28        |
|   | (46,873,573,321.19   | (30,295,751,037.71  |                            | 66,560,235,929.7     |                             |
| Less Earned Revenue                               | )                    | )                   | (783,849,426.85)           | 2                    | (11,392,937,856.03)         |
|   | (14,299,354,730.95   | (24,590,320,980.24  |                            | 64,621,045,834.5     |                             |
| <b>Net Program Costs</b>                          | <b>\$ )</b>          | <b>\$ )</b>         | <b>\$ 1,442,583,153.85</b> | <b>\$ 9</b>          | <b>\$ 27,173,953,277.25</b> |
| Less Earned Revenues Not Attributable to Programs | 0.00                 | 0.00                | 0.00                       | 0.00                 | 0.00                        |
|   | (14,299,354,730.95   | (24,590,320,980.24  |                            | 64,621,045,834.5     |                             |
| <b>Net Cost of Operations</b>                     | <b>\$ )</b>          | <b>\$ )</b>         | <b>\$ 1,442,583,153.85</b> | <b>\$ 9</b>          | <b>\$ 27,173,953,277.25</b> |

Agency Wide

| <b>STATEMENT OF<br/>CHANGES IN NET<br/>POSITION</b><br>For the period ended<br>June 30, 2007 | Military Retirement<br>Fund | Medicare Eligible<br>Retiree Health Care<br>Fund | Other Earmarked<br>Funds | Eliminations               | Total                         |
|--|-----------------------------|--|--------------------------|----------------------------|-------------------------------|
| Net Position Beginning<br>of the Period  | \$ (758,661,315,668.7<br>0) | \$ (453,467,940,964.4<br>4)                      | \$ 5,371,354,755.03      | \$ 0.00                    | \$ (1,206,757,901,878.<br>10) |
| Net Cost of Operations   | (14,299,354,730.95<br>)     | (24,590,320,980.24<br>)                          | 1,442,583,153.85         | 64,621,045,834.5<br>9      | 27,173,953,277.25             |
| Budgetary Financing<br>Sources   | 0.00                        | 186,000,000.00                                   | 2,219,956,469.60         | (189,031,449.89)           | 2,216,925,019.71              |
| Other Financing<br>Sources   | 0.00                        | 0.00   | (14,676,443.77)          | 7,127,532.12               | (7,548,911.65)                |
| Change in Net Position   | \$ 14,299,354,730.95        | \$ 24,776,320,980.24                             | \$ 762,696,871.98        | \$ (64,802,949,752.3<br>6) | \$ (24,964,577,169.19)        |
| Net Position End of<br>Period  | \$ (744,361,960,937.7<br>5) | \$ (428,691,619,984.2<br>0)                      | \$ 6,134,051,627.01      | \$ (64,802,949,752.3<br>6) | \$ (1,231,722,479,047.<br>30) |

**Other Disclosures**

The Statement of Federal Financial Accounting Standards (SFFAS) 27, "Identifying and Reporting Earmarked Funds," requires the disclosure of Earmarked Funds separately from All Other Funds on the Statement of Changes in Net Position and Balance Sheet. Funds must meet three criteria to be classified as earmarked: (1) a statute committing use of specifically identified revenues for designated purposes, (2) explicit authority to retain the revenues, and (3) a requirement to account and report on the revenues. The Department's earmarked funds are either special or trust funds and use both receipt and expenditure accounts to report activity to the U.S. Treasury. There have been no changes in legislation during or subsequent to this reporting period that significantly changed the purposes of any of the following funds.

The Total column is shown as consolidated and relates only to Earmarked Funds. The Elimination column includes only eliminations associated with Earmarked Funds and excludes the offsetting eliminations from All Other Funds. This exclusion causes assets to not equal liabilities and net position in the note. However, the amounts in the Total column equal the amounts reported for Earmarked Funds on the Balance Sheet.

The SFFAS 27 requires the presentation of gross amounts of Earmarked Funds separate from All Other (nonearmarked) Funds. Cumulative Results of Operations ending balances for Earmarked Funds on the Statement of Changes in Net Position do not agree with the Cumulative Results of Operations for Earmarked Funds reported on the Balance Sheet because the Cumulative Results of Operations on the Balance Sheet are presented net of eliminations. The summation for Military Retirement Fund (MRF), Medicare-Eligible Retiree Health Care Fund (MERHCF), and Other Earmarked Funds is equivalent to the gross amount presented on the Statement of Changes in Net Position.

Military Retirement Fund, 10 United States Code (USC) 1461. The MRF accumulates funds in order to finance, on an actuarially sound basis, the liabilities of the Department's military retirement and survivor benefit programs. Financing sources for the MRF are interest earnings on Fund assets, monthly Department contributions, and annual contributions from the U.S. Treasury. The monthly Department contributions are determined as a percentage of basic pay. The contribution from U.S. Treasury 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. The U.S. Treasury annual contribution also includes the normal cost amount for the concurrent receipt provisions of the FY 2004 National Defense Authorization Act.

Medicare-Eligible Retiree Health Care Fund, 10 USC 1111. The MERHCF accumulates funds to finance, on an actuarially sound basis, liabilities of the Department and the uniformed services health care programs for specific Medicare-eligible beneficiaries. The MERHCF was authorized by Public Law 106-398. Financing sources for MERHCF are provided primarily through an annual actuarial liability payment from U.S. Treasury, annual contribution(s) from the Military Services and other Uniformed Services (U.S. Coast Guard, the National Oceanic and Atmospheric Administration, and the U.S. Public Health Service), and interest earned from the Fund's investments.

## **Other Earmarked Funds**

Special Recreation Use Fees, 16 USC 4061-6a note. The United States Army Corps of Engineers (USACE) is granted the authority to charge and collect fair and equitable Special Recreation Use Fees at campgrounds located at lakes or reservoirs that are under the jurisdiction of the USACE. Types of allowable fees include, but are not limited to, daily use fees, admission fees, recreational fees, annual pass fees, and other permit type fees. The receipts are used for the operation and maintenance of the recreational sites.

Hydraulic Mining in California, Debris, 33 USC 683. Operators of hydraulic mines through which debris flows in part or in whole to a body restrained by a dam or other work erected by the California Debris Commission are required to pay an annual tax as determined by the Commission. Taxes imposed under this code are collected and then expended under the supervision of the USACE and the direction of the Department of the Army. The funds are used for repayment of funds advanced by the federal government or other agency for construction, restraining works, settling reservoirs, and maintenance.

Payments to States, Flood Control Act of 1954, 33 USC 701c-3. Seventy-five percent of all funds received and deposited from the leasing of lands acquired by the United States for flood control, navigation and allied purposes, including the development of hydroelectric power, are returned to the state on which the property is located. The USACE collects lease receipts into a receipt account. Funds are appropriated for the amount of receipts the following fiscal year. The funds may be expended by the states for the benefit of public schools and public roads of the county, or counties, in which such property is situated, or for defraying any of the expenses of county government.

Maintenance and Operation of Dams and Other Improvements of Navigable Waters, 16 USC 803(f) and 810. The USC states, "All proceeds from any Indian reservation shall be placed to the credit of the Indians of such reservation." However, the USC also states, "all other charges arising from licenses" except those charges established by the Federal Power Commission, now known as the Federal Energy Regulatory Commission, for purpose of administrative reimbursement shall be paid to the U.S. Treasury from which specific allocations will be made. From the specific allocations, 50% of charges from "all other licenses" is reserved and appropriated as a special fund in the U.S. Treasury to be expended under the direction of the Secretary of the Army in the maintenance, operation and improvement of dams and other navigation structures that are owned by the United States or in construction, maintenance, or operation of headwater or other improvements of navigable waters of the United States.

Fund for Non-Federal Use of Disposal Facilities (for dredged material), 33 USC 2326. Any dredged material disposal facility under the jurisdiction of, or managed by, the Secretary of the Army (Secretary) may be used by a nonfederal interest if the Secretary determines that such use will not reduce the availability of the facility for project purposes. Fees may be imposed to recover capital, operation and maintenance costs associated with such use. Any monies received through collection of fees under this law shall be available to, and used by, the Secretary for the operation and maintenance of the disposal facility from which the fees were collected.

South Dakota Terrestrial Wildlife Habitat Restoration Trust Fund, Public Law 106-53 Sec. 603. Yearly transfers are made from the General Fund of the U.S. Treasury to the Trust Fund for investment purposes. Investment activity is managed by the Bureau of the Public Debt (BPD). The BPD purchases and redeems nonmarketable market-based securities issued by the BPD. Investments include one-day certificates, bonds and notes. When the fund reaches the aggregate amount of \$108 million, withdrawals may be made by the USACE for payment to the State of South Dakota. The state uses the payments to fund the annually scheduled work for wildlife habitat restoration.

Coastal Wetlands Restoration Trust Fund and Coastal Wetlands Planning, Protection and Restoration Act, 16 USC 3951-3956. The USACE, (along with the Environmental Protection Agency, and the Fish and Wildlife Service) is granted the authority to work with the State of Louisiana to develop, review, evaluate, and approve a plan to achieve a goal of "no net loss of wetlands" in coastal Louisiana. The USACE is also responsible for allocating funds among the named task force members. Federal contributions are established at 75% of project costs or 85% if the State has an approved Coastal Wetlands Conservation Plan.

Rivers and Harbors Contributed and Advance Funds, 33 USC 701h, 702f, and 703. Whenever any state or political subdivision offers to advance funds for a flood control project duly adopted and authorized by law, the Secretary of the Army may, in his discretion, receive such funds and expend them in the immediate prosecution of such work. The funding may be used to construct, improve, and maintain levees, water outlets, flood control, debris removal, rectification and enlargement of river channels, etc. in the course of flood control and river/harbor maintenance.

Inland Waterways Trust Fund, 26 USC 9506. This law made the Inland Waterways Trust Fund available for USACE expenditures for navigation, construction, and rehabilitation projects on inland waterways. Collections for excise taxes from the public are made into the Trust Fund. The collections are invested and investment activity is managed by the BPD. The BPD purchases and redeems nonmarketable market-based securities issued by the BPD. Investments include one-day certificates, bonds and notes. The fund is classified as a trust fund and utilizes receipt and expenditure accounts in accounting for and reporting the fund.

Harbor Maintenance Trust Fund, 26 USC 9505. The USACE Civil Works mission is funded by the Energy and Water Developments Appropriations Act. The Water Resources Development Act of 1986 was implemented to cover a portion of USACE operations and maintenance costs for deep draft navigation. The Harbor Maintenance Trust Fund is available for making expenditures to carry out the functions specified in the act and for the payment of all expenses of administration incurred by the U.S. Treasury, USACE, and the Department of Commerce. Collections are made into the Trust Fund from taxes collected from imports, domestics, passengers and foreign trade. The collections are invested and investment activity is managed by the BPD. The fund is classified as a trust fund and utilizes receipt and expenditure accounts in accounting for and reporting the fund.

Foreign National Employees Separation Pay Account Trust Fund, 10 USC 1581. This fund makes payments from amounts obligated by the Secretary of Defense that remain unexpended for separation pay for foreign national employees of the Department. The foreign national employees' separation pay funded by Foreign Military Sales administrative funds is maintained as a separate fund.

Defense Commissary Agency Surcharge Trust Fund, 10 USC 2685. This fund was established as the repository for the surcharge on sales of commissary goods paid for by authorized patrons to finance certain operating expenses and capital purchases of the Commissary System, which are precluded by law from being paid with appropriated funds. Most Surcharge public revenue is generated by the 5% surcharge applied to each sale. These funds may be used to pay for the commissary store-related information technology investments, to purchase commissary equipment, to finance advance design modifications to prior year projects, for both minor and major construction projects, and to maintain and repair commissary facilities and equipment. The surcharge account also allows for obligations based on anticipated proceeds without regard to fiscal year limitations, if needed to carry out the purposes of the Fund.

Education Benefit Fund, 10 USC 2006. This fund was established to finance, on an actuarially sound basis, the liabilities of the Department's education benefit programs for current and former active duty, guard and reserve members of the armed forces, and members of the Coast Guard. Financing sources for the Education Benefit Fund are interest earnings on Fund assets and monthly Department contributions.

Voluntary Separation Incentive Fund, 10 USC 1175. This fund was established to finance, on an actuarially sound basis, the liabilities of the Department's incentive program for early separation from military service. Financing sources for the Voluntary Separation Incentive Fund are interest earnings on Fund assets and annual Department contributions.

|                 |                          |
|-----------------|--------------------------|
| <b>Note 24.</b> | <b>Other Disclosures</b> |
|-----------------|--------------------------|

| As of June 30 | 2007               |           |       |       |
|---------------|--------------------|-----------|-------|-------|
|               | Asset Category     |           |       |       |
|               | Land and Buildings | Equipment | Other | Total |

**1. ENTITY AS LESSEE-  
Operating Leases**

Future Payments Due

Fiscal Year

|               |                   |                 |                   |                   |
|---------------|-------------------|-----------------|-------------------|-------------------|
| 2007          | \$ 139,997,008.45 | \$ 2,330,849.56 | \$ 134,583,335.00 | \$ 276,911,193.01 |
| 2008          | 247,842,978.50    | 1,647,636.18    | 138,620,835.00    | 388,111,449.68    |
| 2009          | 241,632,682.13    | 1,003,975.00    | 142,779,460.00    | 385,416,117.13    |
| 2010          | 234,586,679.44    | 1,022,999.38    | 147,062,844.00    | 382,672,522.82    |
| 2011          | 224,187,972.36    | 1,044,074.36    | 151,474,729.00    | 376,706,775.72    |
| 2012          | 200,306,803.73    | 1,062,201.22    | 156,018,971.00    | 357,387,975.95    |
| After 5 Years | 218,896,912.04    | 1,082,381.25    | 160,699,540.00    | 380,678,833.29    |

**Total Future Lease  
Payments Due**

|  |                     |                 |                     |                     |
|--|---------------------|-----------------|---------------------|---------------------|
|  | \$ 1,507,451,036.65 | \$ 9,194,116.95 | \$ 1,031,239,714.00 | \$ 2,547,884,867.60 |
|--|---------------------|-----------------|---------------------|---------------------|

Agency Wide

**Note 25.**

**Restatements**

The Department did not record any restatements during FY 2007.