

FISCAL YEAR 2008 AGENCY FINANCIAL REPORT



Section 3: Other Accompanying Information

Detailed Defense Security Cooperation Agency

Principal Financial Statements and Notes

Department of Defense

November 17, 2008

Department of Defense Agency Financial Report 2008

The FY 2007 DoD financial statements included certain programs of the Executive Office of the President (EOP). Revised guidance from the Office of Management and Budget (OMB) declared that these programs should be reported separately from the DoD financial statements. The following Defense Security Cooperation Agency financial statements include these programs executed on behalf of EOP. The DoD continues to report activity resulting from EOP allocation transfers within the DoD financial statements.

Department of Defense Agency Financial Report 2008

Consolidated Balance Sheet Security Assistance	Dollars in Thousands	
	2008 Consolidated	2007 Consolidated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$ 16,624,832	\$ 11,917,866
Accounts Receivable (Note 5)	0	(1)
Total Intragovernmental Assets	\$ 16,624,832	\$ 11,917,865
Cash and Other Monetary Assets (Note 7)	13,299,859	12,436,904
Accounts Receivable, Net (Note 5)	21,406	18,030
Loans Receivable (Note 8)	1,410,888	2,994,865
Other Assets (Note 6)	11,095,636	9,384,649
TOTAL ASSETS	\$ 42,452,621	\$ 36,752,313
LIABILITIES (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	0	(1)
Debt (Note 13)	725,558	2,935,266
Other Liabilities (Note 15)	705,857	79,895
Total Intragovernmental Liabilities	\$ 1,431,415	\$ 3,015,160
Accounts Payable (Note 12)	826,108	978,479
Military Retirement and Other Federal Employment Benefits (Note 17)	339	328
Other Liabilities (Note 15)	36,425,837	29,198,970
Commitments & Contingencies (Note 16)		
TOTAL LIABILITIES	\$ 38,683,699	\$ 33,192,937
NET POSITION		
Unexpended Appropriations - Other Funds	2,385,718	2,319,244
Cumulative Results of Operations - Other Funds	1,383,204	1,240,132
TOTAL NET POSITION	\$ 3,768,922	\$ 3,559,376
TOTAL LIABILITIES AND NET POSITION	\$ 42,452,621	\$ 36,752,313

Consolidated Statement of Net Cost Security Assistance		<i>Dollars in Thousands</i>	
	2008 Consolidated	2007 Consolidated	
Program Costs			
Gross Costs	\$ 19,604,795	\$ 19,845,893	
(Less: Earned Revenue)	(84,107)	(110,597)	
Net Program Costs	\$ 19,520,688	\$ 19,735,296	
Net Cost of Operations	\$ 19,520,688	\$ 19,735,296	

Consolidated Statement of Changes in Net Position Security Assistance		Dollars in Thousands							
		For Periods ended September 30, 2008 and 2007							
	2008 Earmarked Funds	2008 All Other Funds	2008 Eliminations	2008 Consolidated	2007 Earmarked Funds	2007 All Other Funds	2007 Eliminations	2007 Consolidated	
Cumulative Results Of Operations									
Beginning Balances	\$ 0	\$ 1,240,132	\$ 0	\$ 1,240,132	\$ 0	\$ 63,007	\$ 0	\$ 63,007	
Beginning balances, as adjusted	\$ 0	\$ 1,240,132	\$ 0	\$ 1,240,132	\$ 0	\$ 63,007	\$ 0	\$ 63,007	
Budgetary Financing Sources:									
Appropriations used	0	4,743,894	0	4,743,894	0	4,428,875	0	4,428,875	
Nonexchange revenue	0	14,952,903	0	14,952,903	0	16,645,692	0	16,645,692	
Other budgetary financing sources	0	(18,202)	0	(18,202)	0	0	0	0	
Other Financing Sources:									
Transfers(in/out without reimbursement (+/-))	0	(14,863)	0	(14,863)	0	(99,665)	0	(99,665)	
Other (+/-)	0	28	0	28	0	(62,481)	0	(62,481)	
Total Financing Sources	\$ 0	\$ 19,663,760	\$ 0	\$ 19,663,760	\$ 0	\$ 20,912,421	\$ 0	\$ 20,912,421	
Net Cost of Operations (+/-)	0	19,520,688	0	19,520,688	0	19,735,296	0	19,735,296	
Net Change	\$ 0	\$ 143,072	\$ 0	\$ 143,072	\$ 0	\$ 1,177,125	\$ 0	\$ 1,177,125	
Cumulative Results of Operations	\$ 0	\$ 1,383,204	\$ 0	\$ 1,383,204	\$ 0	\$ 1,240,132	\$ 0	\$ 1,240,132	
Unexpended Appropriations									
Beginning Balances	0	2,319,244	0	2,319,244	0	1,823,135	0	1,823,135	
Beginning balances, as adjusted	\$ 0	\$ 2,319,244	\$ 0	\$ 2,319,244	\$ 0	\$ 1,823,135	\$ 0	\$ 1,823,135	
Budgetary Financing Sources:									
Appropriations received	0	4,850,639	0	4,850,639	0	4,933,184	0	4,933,184	
Appropriations transferred (in/out)	0	0	0	0	0	(7,139)	0	(7,139)	
Other adjustments (rescissions, etc)	0	(40,271)	0	(40,271)	0	(1,061)	0	(1,061)	
Appropriations used	0	(4,743,894)	0	(4,743,894)	0	(4,428,875)	0	(4,428,875)	
Total Budgetary Financing Sources	\$ 0	\$ 66,474	\$ 0	\$ 66,474	\$ 0	\$ 496,109	\$ 0	\$ 496,109	
Unexpended Appropriations	\$ 0	\$ 2,385,718	\$ 0	\$ 2,385,718	\$ 0	\$ 2,319,244	\$ 0	\$ 2,319,244	
Net Position	\$ 0	\$ 3,768,922	\$ 0	\$ 3,768,922	\$ 0	\$ 3,559,376	\$ 0	\$ 3,559,376	

Department of Defense Agency Financial Report 2008

Combined Statement Of Budgetary Resources Security Assistance <i>Dollars in Thousands</i>	Budgetary Financing Accounts		Nonbudgetary Financing Accounts	
	2008 Combined	2007 Combined	2008 Combined	2007 Combined
Budgetary Resources				
Unobligated balance, brought forward, October 1	\$ 10,158	\$ 15,076	\$ 33,757	\$ 15,301
Recoveries of prior year unpaid obligations	7,130	16,720	0	0
Budget authority				
Appropriation	26,681,236	20,753,096	0	13,108
Borrowing authority	0	0	2,402	10,383
Contract authority	28,797,056	48,022,228	0	0
Spending authority from offsetting collections				
Earned				
Collected	103	619	632,573	853,958
Subtotal	\$ 55,478,395	\$ 68,775,943	\$ 634,975	\$ 877,449
Nonexpenditure transfers, net, anticipated and actual	0	(7,139)	0	0
Permanently not available	(21,870,868)	(15,834,265)	(428,418)	(789,296)
Total Budgetary Resources	\$ 33,624,815	\$ 52,966,335	\$ 240,314	\$ 103,454
Obligations incurred:				
Direct	33,434,664	52,956,177	146,287	69,698
Subtotal	\$ 33,434,664	\$ 52,956,177	\$ 146,287	\$ 69,698
Unobligated balance:				
Apportioned	10,866	(224)	27,075	22,980
Subtotal	\$ 10,866	\$ (224)	\$ 27,075	\$ 22,980
Unobligated balance not available	179,285	10,382	66,952	10,776
Total status of budgetary resources	\$ 33,624,815	\$ 52,966,335	\$ 240,314	\$ 103,454

Department of Defense Agency Financial Report 2008

Combined Statement Of Budgetary Resources Security Assistance <i>Dollars in Thousands</i>	Budgetary Financing Accounts		Nonbudgetary Financing Accounts	
	2008 Combined	2007 Combined	2008 Combined	2007 Combined
Change in Obligated Balance:				
Obligated balance, net				
Unpaid obligations, brought forward, October 1	62,299,588	27,965,425	2,740,283	3,039,300
Total unpaid obligated balance	62,299,588	27,965,425	2,740,283	3,039,300
Obligations incurred net (+/-)	33,434,664	52,956,177	146,287	69,699
Less: Gross outlays	(21,916,120)	(18,605,294)	(228,272)	(368,715)
Less: Recoveries of prior year unpaid obligations, actual	(7,131)	(16,720)	0	0
Obligated balance, net, end of period				
Unpaid obligations	73,811,001	62,299,589	2,658,298	2,740,283
Total, unpaid obligated balance, net, end of period	\$ 73,811,001	\$ 62,299,589	\$ 2,658,298	\$ 2,740,283
Net Outlays				
Net Outlays:				
Gross outlays	21,916,120	18,605,294	228,272	368,715
Less: Offsetting collections	(101)	(619)	(632,575)	(853,958)
Less: Distributed Offsetting receipts	(21,830,598)	(15,833,019)	0	0
Net Outlays	\$ 85,421	\$ 2,771,656	\$ (404,303)	\$ (485,243)

Note 1. Significant Accounting Policies

1.A. BASIS OF PRESENTATION

These financial statements have been prepared in accordance with Chief Financial Officers Act of 1990 (CFO) to report the financial position and results of operations of the Foreign Military Sales (FMS) Trust Fund and its accounts and, as identified in the President's Budget Request, the Foreign Operations (International Affairs) appropriated accounts. The FMS Trust Fund has accounts for U.S. Government funds appropriated for security assistance and for funds deposited by foreign countries and international organizations, or by others for their use. The FMS Trust Fund and other accounts for funds appropriated for security assistance are managed by the Defense Security Cooperation Agency (DSCA) on behalf of the Department of Defense (DoD), in accordance with the authority of the Executive Office of the President (EOP), and the requirements of the CFO Act of 1990, as expanded by the "Government Management Reform Act of 1994," and other applicable laws and regulations.

The financial statements were prepared from accounting records that are maintained by the Military Departments (MILDEPs), Other Defense Organizations (ODO), and the Defense Finance and Accounting Service (DFAS) in accordance with DoD "Financial Management Regulation," OMB Circular A-136, "Financial Reporting Requirements," Statements of Federal Financial Accounting Standards (SFFAS), and to the extent possible, U.S. generally accepted accounting principles (USGAAP). The accompanying financial statement information accounts for all FMS Trust Fund resources and the accounts for funds appropriated for security assistance unless otherwise noted. Information relative to classified programs is reported in such a manner that it is not discernable.

The FMS Trust Fund accounting systems, including its sub-accounts and the accounts for funds appropriated for security assistance, are unable to fully implement all elements of USGAAP and OMB Circular A-136 due to limitations of its financial management processes, financial systems, and nonfinancial systems and processes that feed into the financial statements. Many of the accounts derive their reported values and other data and information for major asset and liability categories largely from nonfinancial systems, such as MILDEPs' inventory and logistic systems. Such legacy systems were designed to support reporting requirements for maintaining asset accountability and reporting the status of federal appropriations rather than preparing financial statements consistent with USGAAP. There are ongoing efforts to complete process and system improvements that address these limitations.

The Department currently has several auditor identified financial statement material weaknesses. Material weaknesses affecting the FMS Trust Fund and the accounts for funds appropriated for security assistance may include (1) Financial Management Systems, (2) Intergovernmental Eliminations, (3) Unsupported Accounting Entries, (4) Statement of Net Cost, (5) Reconciliation of Net Cost of Operations to Budget, (6) Accounts Payable, (7) Accounts Receivable, and (8) Fund Balance with Treasury.

1.B. MISSION OF THE REPORTING ENTITY

The DSCA mission is to lead, direct, and manage security cooperation programs and resources to support U.S. national security objectives. Such programs build relationships with foreign countries and international organizations that promote U.S. interests, and develop allied and partner capacities for self-defense and coalition operations in the Global War on Terror, and promote peacetime and contingency access for U.S. forces. The DSCA accomplishes its responsibilities for security cooperation in concert with the Department of State, MILDEPs, other U.S. Government organizations, and U.S. industry and nongovernmental organizations.

Together, we provide financial and technical assistance for Foreign Military Financing (FMF) of defense articles and services, including training provided through the FMS program. as well as training provided and funded under International Military Education and Training (IMET) authorities.

1.C. APPROPRIATIONS AND FUNDS

The FMS Trust Fund is a U.S. Treasury account (Treasury Account Symbol (TAS) 8242) that contains deposits from FMS foreign country and international organization customers, as well as funds transferred into the account from U.S. Government appropriations, for use in carrying out specific purposes or programs in accordance with the Arms Export and Control Act (AECA) (22 U.S.C. § 2751 et seq.); the Foreign Assistance Act (FAA) of 1961, as amended; (22 U.S.C. § 2151 et seq.); and other legal authorities. The monies in the FMS Trust Fund are subject to U.S. Treasury account system controls from the date of receipt to the date of expenditure or refund. At the country or customer level, there are separate sub-accounts used by DoD through DSCA and DFAS to separately and individually account for each FMS customer's deposits, other collections or deposits, payments of bills, refunds, and adjustments. At the U.S. Treasury level, the corpus of the FMS Trust Fund represents the total aggregation of balances (receipts minus disbursements) for all activities and programs.

The Department uses separate U.S. Treasury Accounts for the general fund Foreign Operations (International Affairs) appropriations. These accounts are:

- International Military Education and Training (TAS 1081)
- Foreign Military Financing Program Account (TAS 1082)
- Foreign Military Loan Liquidating Account (TAS 4121)
- Foreign Military Financing Direct Loan Financing Account (TAS 4122)
- Military Debt Reduction Financing Account (TAS 4174)

The DSCA receives its funds for the FMS Trust Fund and the accounts for funds appropriated for security assistance as general, special, and trust funds. The DSCA uses these appropriations and funds to execute its missions and subsequently reports on usage.

General and special appropriations transferred into the FMS Trust Fund are used for financial transactions (including personnel, operations, and maintenance of security assistance functions) and financing of FMS, that may include sales of defense articles and services from stock or through procurement, and the sale of foreign military construction.

The FMS Trust Fund accounts for receipts and expenditures of funds held in trust by the U.S. Government for use in carrying out specific purposes or programs in accordance with applicable laws, regulations, and agreements.

The DSCA is a party to allocation transfers as the child for funds that meet the OMB exception. Thus, all related activity for the following funds are included in DSCA financial statements but are reported separately from the DoD financial statements: International Military Education and Training, Foreign Military Financing Program Account, Foreign Military Loan Liquidating Account, Foreign Military Financing Direct Loan Financing Account, Military Debt Reduction Financing Account, and the FMS Trust Fund. Allocation transfers are legal delegations by one agency of its authority to obligate budget authority and outlay funds to another agency. Generally, all financial activity related to such allocation transfers is reported in the financial statements of the parent entity. Exceptions to this general rule will apply to specific funds for which OMB has directed that all activity will be reported in the financial statements of the child to

which the funds have been transferred. Exceptions include all U.S. Treasury-Managed Trust Funds, EOP, and all other funds specifically designated by OMB.

1.D. BASIS OF ACCOUNTING

For FY 2008, the financial management systems used for the FMS Trust Fund and the accounts for funds appropriated for security assistance were unable to meet all of the requirements for full accrual accounting. Many of the financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of USGAAP guidance for Federal agencies. These legacy systems were not designed to collect and record financial information on a full accrual accounting basis. Most of the legacy systems were designed to record information on a budgetary basis.

The DSCA, with MILDEPs and ODOs, has undertaken efforts to determine the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with USGAAP. 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 the systems and related processes have been updated to collect and report financial information as required, the reported financial data is based on budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and adjustments for known accruals of items such as payroll expenses and liabilities.

1.E. REVENUES AND OTHER FINANCING SOURCES

As authorized by legislation, payments for the sales of defense articles and services are deposited into the FMS Trust Fund. Appropriations provided on an annual or multi-year basis for security assistance are a financing source and are transferred into the FMS Trust Fund or deposited into the accounts for funds appropriated for security assistance. Pricing for defense articles and services, including training, is established to recover costs as required by the AECA, the FAA, and OMB Circular A-25, "Transmittal Memorandum #1, User Charges." The FMS Trust Fund and the accounts for funds appropriated for security assistance recognize revenue when earned within the constraints of current system capabilities.

The DSCA does not include nonmonetary support provided by friendly foreign countries and international organizations in amounts reported in the Statement of Net Cost and in Note 21, Reconciliation of Net Cost of Operations to Budget. The DSCA participates in assistance in kind agreements in its overseas presence.

1.F. RECOGNITION OF EXPENSES

DoD policy requires the recognition of operating expenses in the period incurred. However, the financial systems for the FMS Trust Fund and the accounts for funds appropriated for security assistance were not designed to collect and record transactions on an accrual accounting basis; therefore, accrual adjustments are made for major items such as payroll expenses, accounts payable, and unbilled revenue.

1.G. ACCOUNTING FOR INTRAGOVERNMENTAL ACTIVITIES

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within DoD or between two or more Federal agencies. However, DSCA cannot accurately identify most of its intragovernmental transactions because the MILDEP systems do not track buyer and seller data needed to match related transactions. In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances and intragovernmental balances are then eliminated. The FMS Trust Fund and the accounts for funds appropriated for

security assistance properly eliminate the revenue results from intra-DoD sales of capitalized assets. The Department is developing long-term system improvements that will include sufficient upfront edits and controls to eliminate the need for after the fact reconciliations. The volume of intragovernmental transactions is so large that after the fact reconciliation cannot be accomplished effectively with existing or foreseeable resources.

The U.S. Treasury Financial Management Service is responsible for eliminating transactions between DoD and other federal agencies. The U.S. 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 Policy Guide" provide guidance for reporting and reconciling intragovernmental balances. The FMS Trust Fund and the accounts for funds appropriated for security assistance are unable to fully reconcile intragovernmental transactions with all Federal partners; however, the FMS Trust Fund is able to reconcile balances pertaining to borrowing 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 DoD's proportionate share of public debt and related expenses to the Federal Government is not included. The Federal Government does not apportion debt and its related costs to Federal agencies. Therefore, DoD's financial statements do not report any portion of the public debt or interest thereon nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

1.H. TRANSACTIONS WITH FOREIGN GOVERNMENTS AND INTERNATIONAL ORGANIZATIONS

The FMS Trust Fund and the accounts for funds appropriated for security assistance, through DoD Components and the U.S. Coast Guard, provide defense articles and services, including training, to friendly foreign governments and international organizations under the provisions of the AECA, the FAA, and other legal authorities. The DoD has authority to sell defense articles and services to friendly foreign countries and international organizations at no profit or loss to the U.S. Government. Payments are required to be made in U.S. dollars and in advance of delivery.

1.I. FUNDS WITH THE U.S. TREASURY

The FMS Trust Fund monies are held in U.S. Treasury accounts and the Federal Reserve Bank in individual accounts established by the U.S. for foreign countries. Funds held in the Federal Reserve Bank are transferred to the FMS Trust Fund account to be disbursed for FMS purposes.

For monetary financial resources maintained in U.S. Treasury accounts, the disbursing offices of 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 FMS Trust Fund and the accounts for funds appropriated for security assistance cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports that give the U.S. Treasury information 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. The FMS Trust Fund and the accounts for funds appropriated for security assistance recorded balance in FBWT accounts and U.S. Treasury's FBWT accounts must balance

monthly.

1.J. FOREIGN CURRENCY

The FMS Trust Fund only accepts U.S. dollars for payment of defense articles and services. All payments and collections involved in the FMS Trust Fund are in U.S. dollars.

1.K. ACCOUNTS RECEIVABLE

The FMS Trust Fund and the accounts for funds appropriated for security assistance, as presented in the Balance Sheet, accounts receivable includes accounts, claims, and refunds receivable. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. In the ordinary course of business, the FMS Trust and the accounts for funds appropriated for security assistance by their nature seldom have accounts receivable. 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.

1.L. DIRECT LOANS AND LOAN GUARANTEES

The DSCA administers the Foreign Military Financing program on behalf of the EOP. Direct loans and loan guarantees are authorized by sections 23 and 24 of the AECA (PL 90-269) and other specific legislation. These loans and guarantees assist friendly foreign countries and international organizations in purchasing U.S. defense articles and services. The direct loans and loan guarantees related to Foreign Military Sales are reported separately from the basic financial statements.

1.M. INVENTORIES AND RELATED PROPERTY

The FMS Trust Fund and the accounts for funds appropriated for security assistance do not maintain inventory. The defense articles are provided to the FMS customer from the U.S. Government or the contractor pursuant to a contract with the U.S. Government. Defense articles sold from DoD or the U.S. Coast Guard are assets of the providing component until title is transferred to foreign customer.

1.N. INVESTMENTS IN U.S. TREASURY SECURITIES

Not applicable.

1.O. GENERAL PROPERTY, PLANT, AND EQUIPMENT

Not applicable

1.P. ADVANCES AND PREPAYMENTS

When advances are permitted by law, legislative action, or presidential authorization, DoD's policy is to record advances and prepayments in accordance with USGAAP. As such, payments made in advance of the receipt of goods and services are reported as an asset on the Balance Sheet. The DoD's policy is to expense and/or properly classify assets when the related goods and services are received. Not all military services who execute on behalf DSCA have implemented this policy primarily due to system limitations.

1.Q. LEASES

Lease payments for the rental of DSCA operating facilities is contracted for and classified as an

operating leases. The DSCA as the lessee receives the use and possession of leased property, for example real estate, from a lessor in exchange for payment of funds. An operating lease does not substantially transfer all the benefits and risk of ownership. Payments for operating leases are charged to expenses over the lease terms as it becomes payable.

Office space and leases are funded by the FMS Trust Fund. These costs were gathered from existing operating leases and General Services Administration bills. Future year projections use the Consumer Price Index (CPI) rather than the DoD inflation factor. The CPI impacts increases to the leases, especially those at commercial lease sites. The FMS Trust Fund and the accounts for funds appropriated for security assistance do not have capital leases.

1.R. OTHER ASSETS

Other assets includes civil service employee pay advances, travel advances, and certain contract financing payments that are not reported elsewhere on the FMS Trust Fund and the accounts for funds appropriated for security assistance Balance Sheet.

The FMS Trust Fund and the accounts for funds appropriated for security assistance conduct business with commercial contractors using two primary types of contracts: fixed price and cost reimbursable. 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. These payments are designed to alleviate the potential financial burden on contractors performing on certain long-term contracts and facilitate competition for Defense contracts. Contract financing payments 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 Regulation 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 FMS Trust Fund and the accounts for funds appropriated for security assistance recognize 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 FMS Trust Fund and the accounts for funds appropriated for security assistance loss contingencies arise as a result of 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.

1.T. ACCRUED LEAVE

The FMS Trust Fund 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 the 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 transfer in and out of assets without reimbursement.

1.V. TREATIES FOR USE OF FOREIGN BASES

Not applicable.

1.W. COMPARATIVE DATA

The DSCA financial statements and notes are presented on a comparative basis.

1.X. UNEXPENDED OBLIGATIONS

The FMS Trust Fund and the accounts for funds appropriated for security assistance obligate funds to provide defense articles, services, and training for outstanding orders not yet delivered. Unless the title has passed to the FMS customer, the financial statements do not reflect a liability for payment for goods and services not yet delivered. Unexpended obligations include both obligations for which goods and services have been delivered and a liability recognized and obligations for which no delivery has occurred and no liability recognized. The balance of unexpended obligations appears immediately before net outlays in the Statement of Budgetary Resources and is referred to as "Total, unpaid obligated balances, net, end of period."

1.Y. UNDISTRIBUTED DISBURSEMENTS AND COLLECTIONS

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

The FMS Trust Fund and accounts for funds appropriated for security assistance follow DoD policy to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements are recorded in accounts payable. Unsupported undistributed collections are recorded in other liabilities.

1.Z. SIGNIFICANT EVENTS

Beginning in FY 2007, OMB changed the reporting requirements for allocation transfers. Due to this change, DoD reports in its basic financial statements the programs it administers on behalf of the EOP, including the FMS Program. Previously, DoD recorded these programs as “Other Accompanying Information” rather than as part of the basic financial statements. In the 3rd Quarter FY 2008, the FMS Trust Fund and the accounts for funds appropriated for security assistance were separated from the DoD statements and published as a stand alone to accompany the DoD statements.

The Loans Receivable for Foreign Military Loan Liquidating Account was reviewed and determined to be uncollectible thus establishing an allowance for loss. Payments made on behalf of defaulted country payments are reported as Loans Receivable offset by a 100 percent allowance for loss as there is little chance that payment will be received from the loans.

The dollar value of FMS program sales at the end of FY 2008 is greater than the annual sales for FY 2007 and has exceeded the projected sales for FY 2008 by \$10 billion. This increase in sales is reflected in the Financial Statements with increases to the Fund Balance with Treasury; Cash and other Monetary Assets; Other Assets; Other Liabilities; and Cumulative Results of Operations.

The Paris Club signed Agreement on the early repayment of debt for one country on October 18, 2007, was signed by the U. S. representative to the Paris Club on the same date. Under this bilateral agreement, the country agreed to early repayment at market value of its debts to the U.S. Government. This action eliminated the debt for this country, whose scheduled payments had extended for a significant number of years.

Note 2. Nonentity Assets

Nonentity Assets		<i>Dollars in Thousands</i>	
<i>As of September 30</i>	2008	2007	
Intragovernmental Assets			
Fund Balance with Treasury	\$ 12,744,738	\$ 8,526,832	
Total Intragovernmental Assets	\$ 12,744,738	\$ 8,526,832	
Nonfederal Assets			
Cash and Other Monetary Assets	13,299,859	12,436,904	
Accounts Receivable	21,406	18,030	
Other Assets	10,727,113	9,200,884	
Total Nonfederal Assets	\$ 24,048,378	\$ 21,655,818	
Total Nonentity Assets	\$ 36,793,116	\$ 30,182,650	
Total Entity Assets	\$ 5,659,505	\$ 6,569,663	
Total Assets	\$ 42,452,621	\$ 36,752,313	

Nonentity Assets are assets for which the Foreign Military Sales (FMS) Trust Fund maintains stewardship accountability and responsibility to report but that are not available for the agency’s operations.

Fund Balance with Treasury and Cash and Other Monetary Assets consist of advance deposits from friendly countries and international organizations to facilitate purchases of U.S. defense

Department of Defense Agency Financial Report 2008

articles and services based on future requirement forecasts.

Accounts Receivable consists of nonfederal funds owed to the FMS Trust Fund country accounts that are in litigation at Department of Justice or collection status at Defense Finance and Accounting Service. Some portion of these uncollected funds may be payable to the FMS Administrative Surcharge account but are not discernable prior to collection.

Nonfederal Other Assets consists primarily of advances paid to contractors for undelivered defense articles and services intended for future delivery to the FMS customer.

Note 3. Fund Balance with Treasury

Fund Balance with Treasury		<i>Dollars in Thousands</i>	
<i>As of September 30</i>	2008	2007	
Fund Balances			
Appropriated Funds	\$ 2,456,544	\$ 2,406,290	
Trust Funds	12,744,738	8,526,832	
Other Fund Types	1,423,550	984,744	
Total Fund Balances	\$ 16,624,832	\$ 11,917,866	
Fund Balances Per Treasury Versus Agency			
Fund Balance per Treasury	\$ 16,624,832	\$ 0	
Fund Balance per Agency	16,624,832	11,917,866	
Reconciling Amount	\$ 0	\$ (11,917,866)	

The \$1.4 billion reported as Fund Balances, Other Fund Types, consists of funds on deposit for the management of Foreign Military Sales (FMS) Administration; Contract Administrative Services; Transportation; Attrition and General Services Administration Packing, Crating, and Handling.

Status of Fund Balance with Treasury		<i>Dollars in Thousands</i>	
<i>As of September 30</i>	2008	2007	
Unobligated Balance			
Available	\$ 37,942	\$ 22,756	
Unavailable	246,236	21,159	
Obligated Balance not yet Disbursed	76,469,299	65,039,870	
Nonbudgetary FBWT	21,830,604	3,396,120	
NonFBWT Budgetary Accounts	(81,959,249)	(56,562,039)	
Total Fund Balance	\$ 16,624,832	\$ 11,917,866	

Department of Defense Agency Financial Report 2008

Status of Fund Balance with Treasury consists of unobligated and obligated balances. These balances reflect the budgetary authority remaining for disbursements against current or future obligations. In addition, Status includes various accounts that affect either budgetary reporting or FBWT, but not both.

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 and received but not yet paid.

Nonbudgetary FBWT includes entity and nonentity FBWT accounts that do not have budgetary authority, such as unavailable receipt accounts or clearing accounts. The Nonbudgetary FBWT consists of Global War on Terror (GWOT) funding provided to Department of Defense in supplemental appropriations and GWOT funding transferred from the Department of State and that the Department of State received in supplemental appropriations. Obligations are incurred using contract authority and liquidated with these appropriations.

NonFBWT Budgetary Accounts include budgetary accounts that do not affect FBWT. This category reduces the Status of FBWT. The NonFBWT Budgetary Accounts primarily consists of nonentity cash deposited in the Federal Reserve Bank and contract authority.

Unobligated balances are segregated to show available and unavailable amounts in the note schedule. Certain unobligated balances are restricted to future use and are not apportioned for current use.

Note 5. Accounts Receivable

Accounts Receivable					<i>Dollars in Thousands</i>
<i>As of September 30</i>	2008			2007	
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net	
Intragovernmental Receivables	\$ 0	N/A	\$ 0	\$ (1)	
Nonfederal Receivables (From the Public)	21,406	0	21,406	18,030	
Total Accounts Receivable	\$ 21,406	\$ 0	\$ 21,406	\$ 18,029	

Note 6. Other Assets

Other Assets		<i>Dollars in Thousands</i>	
<i>As of September 30</i>	2008	2007	
Nonfederal Other Assets			
Outstanding Contract Financing Payments	\$ 1,126,044	\$ 183,765	
Advances and Prepayments	9,969,592	8,015,342	
Other Assets (With the Public)	0	1,185,542	
Total Nonfederal Other Assets	\$ 11,095,636	\$ 9,384,649	
Total Other Assets	\$ 11,095,636	\$ 9,384,649	

Contract terms and conditions for certain types of contract financing payments convey certain rights to the Foreign Military Sales (FMS) Trust Fund and the accounts for funds appropriated for security assistance 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 FMS Trust Fund and the accounts for funds appropriated for security assistance is not obligated to make payment to the contractor until delivery and acceptance of a satisfactory product.

The Contract Financing Payment balance of \$1.1 billion consists of \$757 million in contract financing payments and an additional \$368 million in estimated future payments that will be paid to the contractor upon future delivery and Government acceptance of a satisfactory product. (See Note 15, Other Liabilities, for additional information.)

Note 7. Cash and Other Monetary Assets

Cash and Other Monetary Assets		<i>Dollars in Thousands</i>	
<i>As of September 30</i>	2008	2007	
Cash	\$ 13,299,859	\$ 12,436,904	
Total Cash, Foreign Currency, and Other Monetary Assets	\$ 13,299,859	\$ 12,436,904	

Restricted cash of \$13.3 billion includes advance deposits from foreign nations in the Federal Reserve Bank which are unavailable for agency use (nonentity cash) and have not been transferred to the Foreign Military Sales Trust Fund.

Note 8. Direct Loan and Loan Guarantees

DIRECT LOAN AND LOAN GUARANTEE PROGRAMS

The DSCA operates the following Direct Loans Programs:

The Arms Export Control Act, as amended, authorizes funds to be appropriated to the President for financing the sales of defense articles and defense services to eligible foreign countries. Each loan is reviewed in the light of the purchasing country's financial condition, its need for credit, U.S. economic or military assistance programs in the country and region, and other proposed arms purchases by the country. The President delegates to the Secretary of Defense the authority to issue and guaranty loans through the designated administering agency, DSCA. The loans are issued to friendly, less-economically-developed countries. Pursuant to the authority contained in the Act, DSCA operates four funds. For pre-1992 loans, the fund is known as: Foreign Military Loan Liquidating Account (FMLLA). For post-1991 loans, the funds are known as the Foreign Military Direct Loan Program and Financing Accounts, and the Military Debt Reduction Financing Account (MDRFA), used to reduce loan receivables for eligible countries.

The FMLLA is a liquidating account that includes all assets, liabilities, and equities for loan balances recorded prior to FY 1992. No new loan disbursements are made from this account. Certain collections made into this account are made available for default claim payments. The Federal Credit Reform Act (FCRA) provides permanent indefinite authority to cover obligations for default payments in the event the funds in the liquidating account are otherwise insufficient.

Foreign Military Financing Direct Loan Program (FMFDLP) account is a program account that was established pursuant to the FCRA to provide the funds necessary for the subsidy element of loans. Expenditures from this account finance the subsidy element of direct loan disbursements and are transferred into the Foreign Military Financing Direct Loan Financing (FMFDLF) account to make required loan disbursements for approved FMS or commercial sales. For the purpose of this report, FMFDLP accounting transactions, to the extent they are relevant to the FMFDLF account, are included in the data reported for the FMFDLF account.

The FMFDLF account is a financing account used to make disbursements of Foreign Military Loan funds for approved procurements and for subsequent collections for the loans after September 30, 1991. The account uses permanent borrowing authority from the U.S. Treasury combined with transfers of appropriated funds from the FMFDLP account to make the required disbursements to loan recipient country borrowers for approved procurements. Receipts of debt service collections from borrowers are used to repay borrowings from U.S. Treasury.

Military Debt Reduction Financing Account (MDRFA) is a financing account that was established for the debt relief of certain countries as established by Public Law 103-87. The MDRFA buys the portfolio of loans from the FMLLA, thus transferring the loans from the FMLLA account to the MDRFA account. The Paris Club negotiates the debt forgiveness with Highly Indebted Poor Countries (HIPC).

The Paris Club has 19 member countries that negotiate rescheduling or refinancing of debt for HIPC. The Paris Club provides debt reduction initially on payments coming due over a specific period that correspond to the length of an International Monetary Fund (IMF) supported economic reform program. Reduction is then staged, with each successive stage contingent upon debtor country compliance with its IMF-support program. Under Naples Terms, stock of debt reduction is provided after 3 years of good performance with respect to IMF reform programs and payments to Paris Club creditors. The U.S. incurs the budget cost of the eventual stock of debt reduction when it agrees to the initial "maturities" reduction of payments coming

Department of Defense Agency Financial Report 2008

due, since bilateral agreements commit us to stock reduction once the Paris Club agrees to provide them.

The FCRA 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: (1) loan disbursements; (2) repayments of principal; and (3) payments of interest and other payments over the life of the loan after adjusting for estimated defaults, prepayments, fees, penalties, and other recoveries.

Summary of Direct Loans and Loan Guarantees		<i>Dollars in Millions</i>
<i>As of September 30, 2008 and 2007</i>	2008	2007
Loans Receivable		
Direct Loans:		
Foreign Military Loan Liquidating Account	\$ 1,393,736	\$ 2,683,113
Foreign Military Financing Account	7,468	92,720
Military Debt Reduction Financing Account	9,684	219,032
Total Loans Receivable	\$ 1,410,888	\$ 2,994,865

Other Disclosures:

In accordance with a Paris Club agreement, one country paid off their loan balance at a discounted rate. The U.S. Government provided the difference between the amount paid by the country and the Present Value of the loans. The calculations for the credit subsidy estimated are performed during the fourth quarter of the fiscal year. The Paris Club agreement was not considered when calculating the subsidy, which resulted in a credit subsidy for potential defaults that no longer have outstanding loans.

Direct Loans Obligated		<i>Dollars in Millions</i>
<i>As of September 30, 2008 and 2007</i>	2008	2007
Direct Loans Obligated After FY 1992 (Allowance for Loss Method):		
Foreign Military Loan Liquidating Account:		
Loans Receivable Gross	\$ 1,183,766	\$ 1,364,087
Interest Receivable	1,402,924	1,319,026
Allowance for Loan Losses	(1,192,954)	0
Value of Assets Related to Direct Loans	\$ 1,393,736	\$ 2,683,113
Direct Loans Obligated After FY 1991 (Present Value Method):		
Foreign Military Financing Account:		
Allowance for Subsidy Cost (Present Value)	7,468	92,720
Value of Assets Related to Direct Loans	\$ 7,468	\$ 92,720
Military Debt Reduction Financing Account:		
Loans Receivable Gross	190,913	512,128
Interest Receivable	31,323	25,282
Allowance for Subsidy Cost (Present Value)	(212,552)	(318,378)
Value of Assets Related to Direct Loans	\$ 9,684	\$ 219,032
Total Direct Loans Receivable	\$ 1,410,888	\$ 2,994,865

Other Disclosures:

The DSCA bills the countries every 6 months for loan repayments. Accrued interest receivable is calculated as simple interest, based on the terms of the loans with the countries. Interest on unpaid balances due is accrued at the same interest rate as the loan interest rate except for loans that are owed to the Federal Financing Bank where an extra four percent is added to the current interest rate.

The allowance for credit subsidy account for the Financing Direct Loan Financing account is calculated taking into consideration three transactions: (1) transfers of subsidy from the program account to the financing account (the subsidy is the difference between the expected cash outlays from the U.S. Government and the present value of the expected collections); (2) interest payments from the U.S. Treasury to the financing fund; and (3) upward adjustments due to reestimates as U.S. Treasury borrowing rates change over time from the loan repayment rate and an increase in estimated defaults on the loan.

The abnormal debit balance for allowance of \$7.5 million in the FMFDLF is the unamortized portion of the subsidy that results from a credit balance and reflects the cost of the loan to the U.S. Government. A debit balance results from: (1) interest expense paid on U.S. Treasury borrowings; and (2) downward adjustments due to re-estimates when the loan repayment rate exceeds the U.S. Treasury borrowing rate, and a decrease in estimated defaults. The loans in the FMFDLF account are categorized as moderate to medium risk and were expected to have an increasing amount of defaults over the years. This was built into the subsidy amount. As the loan matured, none of the loans defaulted, and the U.S. Treasury borrowing rates fell below some of the loan interest rates. This resulted in downward re-estimates and a negative subsidy rate for the loans, which resulted in a debit balance in the allowance for subsidy. This unexpected debit balance has occurred for several years due to the downward re-estimates due to zero defaults.

Total Amount of Direct Loans Disbursed		<i>Dollars in Thousands</i>	
<i>As of September 30, 2008 and 2007</i>	2008	2007	
Direct Loan Programs			
Foreign Military Financing Account	\$ 95,055	\$	299,017
Total Direct Loan Programs	\$ 95,055	\$	299,017

Department of Defense Agency Financial Report 2008

Subsidy Expense for Direct Loan by Program					
<i>As of September 30, 2008 and 2007</i>			<i>Dollars in Millions</i>		
2008	Modifica- tions	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
Direct Loan Modifications and Reestimates:					
Foreign Military Financing Account	\$ 0	\$ 70,263	\$ 0	\$ 70,263	\$ 70,263
Military Debt Reduction Financing Account	0	(46,447)	0	(46,447)	(46,447)
Total	\$ 0	\$ 23,816	\$ 0	\$ 23,816	\$ 23,816
2007	Modifica- tions	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
Direct Loan Modifications and Reestimates:					
Foreign Military Financing Account	\$ 0	\$ 62,545	\$ 0	\$ 62,545	\$ 62,545
Total	\$ 0	\$ 62,545	\$ 0	\$ 62,545	\$ 62,545
	2008	2007			
Total Direct Loan Subsidy Expense:					
Foreign Military Financing Account	\$ 70,263	\$ 62,545			
Military Deb Reduction Financing Account	(46,447)	0			
Total	\$ 23,816	\$ 62545			

Schedule for Reconciling Subsidy Cost Allowance Balances for Post FY1991 Direct Loans		
		<i>Dollars in Millions</i>
<i>As of September 30, 2008</i>	2008	Restated 2007
Beginning Balance, Changes, and Ending Balance:		
Beginning Balance of the Subsidy Cost Allowance	\$ 225,658	\$ (54,899)
Adjustments		
Loans Written Off	(20)	(4,999)
Subsidy Allowance Amortization	(44,370)	223,011
Total of the above Adjustment Components	\$ (44,390)	\$ 218,012
Ending Balance of the Subsidy Cost Allowance before Reestimate	\$ 181,268	\$ 163,113
Add or Subtract Subsidy Reestimate by Component		
Interest Rate Reestimate	23,816	62,545
Total of the above Reestimate Components	23,816	62,545
Ending Balance of the Subsidy Cost Allowance	\$ 205,084	\$ 225,658

ADMINISTRATIVE EXPENSES

Administrative expenses for loans are not funded in the loan program account. The Office of Management and Budget made the decision to fund administration of loans in the FMF Grant account (11*1082) since the dollar amount was so low. The DSCA administrative expenses for security assistance accounts are funded in the FMF Grant account.

Note 11. Liabilities Not Covered by Budgetary Resources

Liabilities Not Covered by Budgetary Resources		<i>Dollars in Thousands</i>	
<i>As of September 30</i>	2008	2007	
Intragovernmental Liabilities			
Debt	\$ 0	\$	1,837,074
Other	705,857		76
Total Intragovernmental Liabilities	\$ 705,857	\$	1,837,150
Nonfederal Liabilities			
Military Retirement and Other Federal Employment Benefits	339		328
Total Nonfederal Liabilities	\$ 339	\$	328
Total Liabilities Not Covered by Budgetary Resources	\$ 706,196	\$	1,837,478
Total Liabilities Covered by Budgetary Resources	\$ 37,977,503	\$	31,355,459
Total Liabilities	\$ 38,683,699	\$	33,192,937

The liabilities not covered by Budgetary Resources are primarily custodial liabilities to the U.S. Treasury for pending payments on renegotiated loans from foreign countries. Amounts collected are returned to miscellaneous receipts of the Treasury.

Intragovernmental Liabilities Other, represents the principal and interest outstanding on the renegotiated loans discussed above.

Military Retirement and Other Federal Employment Benefits Not Covered by Budgetary Resources represents Federal Employee Compensation Act liabilities not due and payable during the fiscal year. Refer to Note 17, Military Retirement and Other Federal Employment Benefits, for additional details and disclosures.

Note 12. Accounts Payable

Accounts Payable		<i>Dollars in Thousands</i>		
<i>As of September 30</i>	2008			2007
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
Intragovernmental Payables	\$ 0	N/A	\$ 0	\$ (1.0)
Nonfederal Receivables (To the Public)	826,108.0	0	826,108.0	978,479.0
Total Accounts Payable	\$ 826,108.0	\$ 0	\$ 826,108.0	\$ 978,478.0

The systems used by the Foreign Military Sales Trust Fund (FMSTF) and the accounts for funds appropriated for security assistance do not track intragovernmental transactions by customer at the transaction level. Therefore, the FMSTF does not report and cannot reconcile accounts payable with other Federal entities.

In FY 2007, the Department recognized nonfederal accounts payable balances of the Mechanization of Contract Administration Services (MOCAS) system at gross value without reductions for partial, progress payments, and nonaccounts payable records overstating accounts payable and expenses. The overstated balances for FY 2007 were undeterminable due to system limitations; therefore, no corrections have been made. Balances at FY 2008 are properly reported net of nonaccounts payable records, which include partial and progress payments of \$353.3 million.

Note 13. Debt

Debt			<i>Dollars in Thousands</i>		
<i>As of September 30</i>	2008			2007	
	Beginning Balance	Net Borrowing	Ending Balance	Net Borrowing	Ending Balance
Agency Debt (Intragovernmental)					
Debt to the Treasury	\$ 252,154	\$ (214,559)	\$ 37,595	\$ (197,844)	\$ 252,153
Debt to the Federal Financing Bank	2,683,112	(1,995,149)	687,963	(182,500)	2,683,113
Total Debt	\$ 2,935,266	\$ (2,209,708)	\$ 725,558	\$ (380,344)	\$ 2,935,266

The Federal Credit Reform Act (FCRA) of 1990 provides financing accounts with indefinite authority to borrow from the U.S. Treasury to fund disbursements of loans made to sovereign nations for security assistance. This debt to the U.S. Treasury is reflected in the Foreign Military Financing Direct Loan Financing account and the Military Debt Reduction account.

Beginning in January 1975, the DSCA and the Federal Financing Bank (FFB), acting under section 24 of the Arms Export Control Act, as amended, entered into an agreement whereby the FFB would make loan agreements with friendly nations and acquire promissory notes guaranteed by DSCA. The promissory notes are considered DSCA borrowings from the FFB. The promissory notes still owed to the FFB are reflected in the Foreign Military Loan Liquidating account and the Military Debt Reduction account.

The majority of the debt represents direct and guaranteed loans to foreign countries for pre-1992 and post-1991 loans. The FCRA governs all direct loan obligations and loan guarantee commitments made after FY 1991. Before 1992, funds were borrowed from the FFB 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 DSCA must pay the debt if the foreign country borrower defaults on the loan. For loan defaults, DSCA must pay the outstanding principal amounts guaranteed.

Note 15. Other Liabilities

Other Liabilities		<i>Dollars in Thousands</i>			
<i>As of September 30</i>	2008		2007		
	Current Liability	Noncurrent Liability	Total	Total	
Intragovernmental					
FECA Reimbursement to the Department of Labor	\$ 83	\$ 0	\$ 83	\$ 76	
Custodial Liabilities	0	705,774	705,774	0	
Other Liabilities	0	0	0	79,819	
Total Intragovernmental Other Liabilities	\$ 83	\$ 705,774	\$ 705,857	\$ 79,895	
Nonfederal					
Advances from Others	36,035,595	0	36,035,595	28,997,108	
Contract Holdbacks	21,720	0	21,720	18,097	
Contingent Liabilities	0	368,522	368,522	183,765	
Total Nonfederal Other Liabilities	\$ 36,057,315	\$ 368,522	\$ 36,425,837	\$ 29,198,970	
Total Other Liabilities	\$ 36,057,398	\$ 1,074,296	\$ 37,131,694	\$ 29,278,865	

OTHER LIABILITIES

Intragovernmental Other Liabilities consist primarily of liabilities for subsidy related to undisbursed loans and subsidy re-estimation.

Nonfederal Other Liabilities consists primarily of estimated Contingent Liabilities. The Contingent Liabilities balance includes \$368.5 million in estimated future contract financing payments that will be paid to the contractor upon delivery and Government acceptance of a satisfactory product. In accordance with contract terms, specific rights to the contractor's work vests with the Government when a specific type of contract financing payments is made, thereby, protecting taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as the 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 of a satisfactory product. 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 of a satisfactory product.

Note 16. Commitments and Contingencies

Claims may be presented and/or the U.S. Government may be a party in various administrative proceedings or court litigations but it is highly unlikely that any can implicate the Foreign Military Sales Trust Fund. The U.S. funds appropriated for security assistance generally are not legally available for paying claims.

Note 17. Military Retirement and Other Federal Employment Benefits

Military Retirement and Other Federal Employment Benefits					<i>Dollars in Thousands</i>
<i>As of September 30</i>	2008				2007
	Liabilities	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities	Liabilities
Other Actuarial Benefits					
FECA	\$ 339	\$ 0	\$ 0	\$ 339	\$ 328
Total Military Retirement and Other Federal Employment Benefits	\$ 339	\$ 0	\$ 0	\$ 339	\$ 328
<i>Actuarial Cost Method Used: Aggregate Entry-Age Method</i>					
<i>Assumptions: See Below</i>					
<i>Market Value of Investments in Market-based and Marketable Securities: \$374.5 billion</i>					

FEDERAL EMPLOYEES' COMPENSATION ACT

Actuarial Cost Method Used and Assumptions:

The DSCA FMS Trust Fund actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to the FMS Trust Fund at the end of each fiscal year. 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 using a method that uses 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 Treasury notes and bonds. Interest rate assumptions used for discounting were as follows:

FY 2008

- 4.368 % in Year 1
- 4.770 % in Year 2 and thereafter

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIMs) were applied to the calculation of projected future benefits. The actual rates for these factors for the charge back year (CBY) 2008 were also used to adjust the methodology's historical payments to current year constant dollars.

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

Federal Employees - Compensation Act (FECA)		
CBY	COLA	CPIM
2008	3.03%	4.71%
2009	3.87%	4.01%
2010	2.73%	3.86%
2011	2.20%	3.87%
2012	2.23%	3.93%
2013+	2.30%	3.93%

The model's resulting projections were analyzed to ensure that the estimates were reliable. The analysis was based on four tests: (1) a sensitive analysis of the model to economic assumptions; (2) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual incremental payments; (3) a comparison of the incremental paid losses per case (a measure of case-severity) in CBY 2008 to the average pattern observed during the most current three CBYs; and (4) a comparison of the estimated liability per case in the CBY 2008 projection to the average pattern for the projections of the most recent 3 years.

Note 18. General Disclosures Related to the Statement of Net Cost

General Disclosures Related to the Statement of Net Cost		<i>Dollars in Thousands</i>
<i>As of September 30</i>	2008	2007
Intragovernmental Costs	\$ 156,393	\$ 205,677
Public Costs	19,448,402	19,640,216
Total Costs	\$ 19,604,795	\$ 19,845,893
Intragovernmental Earned Revenue	(4,914)	(15,868)
Public Earned Revenue	(79,193)	(94,729)
Total Earned Revenue	\$ (84,107)	\$ (110,597)
Net Cost of Operations	\$ 19,520,688	\$ 19,735,296

Intragovernmental Costs and Revenue relate to transactions made between two reporting entities within the Federal Government.

Public Costs and Revenue are exchange transactions made between the reporting entity and a nonfederal entity.

The systems used by DSCA for the Foreign Military Sales (FMS) Trust Fund and the accounts for funds appropriated for security assistance do not track intragovernmental transactions by a customer at the transaction level.

The Statement of Net Cost represents the net cost of programs and organizations of the Federal Government supported by appropriations or other means. The intent of the Statement of Net Cost is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity. The Department's 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

developing a cost reporting methodology as required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government."

Until all of the FMS Trust Fund and the accounts for funds appropriated for security assistance financial and nonfinancial feeder systems and processes have been updated to collect and report financial information as required, the FMS Trust Fund and the accounts for funds appropriated for security assistance financial data are based on budgetary transactions (obligations, disbursements, and collections); transactions from nonfinancial feeder systems; and adjustments for known accruals of items such as payroll expenses and accounts payable.

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

Other Financing Sources, Other consists of a negative \$18.2 million in Loss on Disposition of Assets that resulted from one country paying off its loan balance at a discounted value.

The Appropriations Received on Statement of Budgetary Resources does not agree with Appropriations Received on the Statement of Changes in Net Position. The difference of \$21.8 billion is due to the FMS Trust Fund contract authority not being reported as appropriation received on the Statement of Changes in Net Position.

Note 20. Disclosures Related to the Statement of Budgetary Resources

Disclosures Related to the Statement of Budgetary Resources		<i>Dollars in Thousands</i>
<i>As of September 30</i>	2008	2007
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	\$ 85,612,754	\$ 2,309,086

On the statement of Budgetary Resources, obligations incurred of \$33.4 billion are direct and exempt from apportionment.

Borrowings from the U.S. Treasury are required to be repaid once a year at the end of the fiscal year. The financing sources for the repayments on borrowings are loan repayments from the countries or permanent indefinite appropriations through subsidy reestimates.

The portions of the Foreign Military Sales (FMS) Trust Fund receipts collected in the current fiscal year that exceed current outlays are temporarily precluded from obligation by law. However, these receipts are available for obligation as needed in the future.

The Federal Credit Reform Act of 1990 (FCRA) provides permanent indefinite appropriations to fund upward subsidy reestimates that fund repayments of principal and interest of U.S. Treasury borrowings with the FMFDLF and the MDRFA. The FCRA also provides permanent indefinite appropriations to fund loan defaults with the FFB in the FMLLA.

The appropriations received on the Statement of Budgetary Resources do not agree with appropriations received on the Statement of Changes in Net Position. The difference of \$21.8 billion is due to the FMS Trust Fund contract authority not being reported as appropriation received on the Statement of Changes in Net Position.

Note 21. Reconciliation of Net Cost of Operations to Budget

Reconciliation of Net Cost of Operations to Budget		<i>Dollars in Millions</i>	
<i>As of September 30, 2008 and 2007</i>	2008	2007	
Resources Used to Finance Activities:			
Budgetary Resources Obligated:			
Obligations incurred	\$ 33,580,951	\$ 53,025,875	
Less: Spending authority from offsetting collections and recoveries (-)	(639,806)	(871,297)	
Obligations net of offsetting collections and recoveries	\$ 32,941,145	\$ 52,154,578	
Less: Offsetting receipts (-)	(21,830,598)	(15,833,019)	
Net Budgetary Resources Obligated	\$ 11,110,547	\$ 36,321,559	
Other Resources:			
Transfers in/out without reimbursement (+/-)	(14,863)	(99,665)	
Other (+/-)	28	(62,481)	
Net other resources used to finance activities	\$ (14,835)	\$ (162,146)	
Total resources used to finance activities	\$ 11,095,712	\$ 36,159,413	
Resources Used to Finance Items not Part of the Net Cost of Operations			
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided:			
Undelivered Orders (-)	(13,809,945)	(32,818,159)	
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	22,463,172	16,686,977	
Resources that finance the acquisition of assets (-)	(228,271)	(368,715)	
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations:			
Other (+/-)	14,863	162,146	
Total resources used to finance items not part of the Net Cost of Operations	\$ 8,439,819	\$ (16,337,751)	
Total resources used to finance the Net Cost of Operations	\$ 19,535,531	\$ 19,821,662	
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period			
Components Requiring or Generating Resources in Future Period:			
Upward/Downward reestimates of credit subsidy expense (+/-)	(14,862)	(99,481)	
Other (+/-)	19	7	
Total components of Net Cost of Operations that will Require or Generate Resources in future periods	\$ (14,843)	\$ (99,474)	
Components not Requiring or Generating Resources:			
Other	0	13,108	
Total components of Net Cost of Operations that will not Require or Generate Resources in the current period	\$ (14,843)	\$ (86,366)	
Net Cost of Operations	\$ 19,520,688	\$ 19,735,296	

The following note schedule lines are presented as combined instead of consolidated due to intra-agency 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

The \$28 thousand reported under Resources Used to Finance Activities Other represents the offsetting collection for the International Military Education Training Program.

The \$14.9 million reported under Other resources or adjustments to net obligated resources that do not affect the Net Cost of Operations represents the excess cash return to the U.S. Treasury from the Foreign Military Direct Loan Financing Account.

The \$19 thousand Components Requiring or Generating Resources in Future Period, Other represents the amount of employer contributions to benefit programs not requiring current year budget authority and changes in actuarial liabilities.