

# UNITED STATES AIR FORCE

## Annual Financial Statement



2007





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**2007**  
*Financing The Fight*



HERITAGE TO HORIZONS



# Table of Contents

Message from the Secretary of the Air Force.....	ii
Message from the Principal Deputy Assistant Secretary of the Air Force (Financial Management and Comptroller).....	iii
<b>Management Discussion and Analysis</b>	
Air Force Heritage.....	1
Air Force in Action – 2007.....	2
Air Force Structure.....	5
Air Force Smart Operations in the 21st Century – The Way Ahead.....	10
CFO Compliance.....	10
<b>Department of the Air Force General Fund</b>	
Air Force Resources and Organizations.....	11
Air Force Strategic Financial Management and Transformation.....	12
<b>Air Force Working Capital Fund</b>	
Supply Management Activity Group.....	17
Depot Maintenance Activity Group.....	19
<b>Financing The Fight</b>	
<b>Financial Statements</b>	
General Fund	
-Principal Statements.....	25
-Notes to the Principal Statements.....	31
-Required Supplementary Stewardship Information.....	77
-Required Supplementary Information.....	85
-Audit Opinion.....	97
Working Capital Fund	
-Principal Statements.....	105
-Notes to the Principal Statements.....	111
-Required Supplementary Information.....	139
-Audit Opinion.....	143



November 2007

## Message from the Secretary of the Air Force



The year 2007 marks the United States Air Force's 60<sup>th</sup> year as an independent service. We honor this rich heritage through our actions, our values and through our plans for the future. Our legacy and heritage include the Airmen of our past who secured and ensured our nation's air and space dominance, and their legacy serves as a beacon, illuminating our path into the future. Our future poses new challenges and requires innovative personnel who face the financial challenges of modern war in the new millennium. America in the 21<sup>st</sup> century requires the courage and skill of great financial warriors. Our Total Force must be the best organized, trained and equipped, to deal with the new and evolving threats and missions we face as a nation and a service at war.

America's Air Force is engaged in global operations every day, fighting the War on Terror, defending our homeland, providing strategic deterrence and presenting our nation with unparalleled Global Vigilance, Reach and Power. We provide America with the asymmetric advantages of air, space and cyberspace power, but demands for these advantages will not diminish in a world rife with threats.

Indeed, we must face these challenges head on, with the utmost attention, dedication, accountability and professionalism as we manage our Air Force assets. I am pleased and proud to write that these very qualities, represented throughout the Air Force, are highlighted in this FY 2007 Air Force Financial Statement. This Statement conveys the importance we place in being ever vigilant stewards of our nation's trust and its resources.

I cannot overstate the fact that the stewardship of funding entrusted to us by the American people must remain a top Air Force priority. In fact, a pillar of our Air Force Strategic Plan is to "Implement Open, Transparent Business Practices, and Achieve a Clean Audit." This keystone element is vital to our Strategic Plan and it is vital to the Air Force. Air Force Chief of Staff General Michael Moseley and I believe these open and transparent business practices are an essential factor of the Air Force response to the demands of the 21<sup>st</sup> Century.

Responsible financial management is not an option for the United States Air Force, it is a requirement. We will continue to fly, fight and win, and we are dedicated to victory in air, space and cyberspace. We will continue to maintain our Air Force Core Values of "Integrity First, Service Before Self, Excellence in All We Do," and of course, we will continue to serve the American people. In the end, we are stewards of taxpayer dollars, working with utmost responsibility to "Finance the Fight" for the United States Air Force.

Michael W. Wynne



November 2007

**Message from the  
Principal Deputy Assistant Secretary of the Air Force  
(Financial Management)**



As Secretary Wynne points out, the future holds both challenges and great opportunities for America's air, space and cyberspace power. Cognizant of our heritage and poised for the challenges of tomorrow, we stand ready with innovative leadership and a Total Force effort. This report details how Air Force financial management professionals have built the foundation from which we meet our current and future challenges.

During FY 2007, Air Force Financial Management professionals demonstrated that the goal articulated by the Secretary to "Implement Open, Transparent Business Practices, and Achieve a Clean Audit," was more than just a phrase; our team has turned it into our charter. This charter will remain a keystone of Air Force Financial Management, just as we remain diligent stewards of the Air Force's financial resources.

We are meeting these targets and our many other goals by transforming the way the Air Force does business. We are breaking out of "Industrial Age" business processes and embracing "Information Age" thinking. Our approach recognizes that in air, space and cyberspace, the most important customer of financial management professionals is the American warfighter. He or she might be in the cockpit, on the flightline, at a launch site, or at a computer screen, but the warfighter remains our focus; their mission success is of paramount importance to the financial management team.

As this statement details, we have made excellent progress in Financial Management transformation. Air Force Smart Operations for the 21<sup>st</sup> Century (AFSO21) continues to form an important element of this transformation as we improve our systems to provide more robust capabilities that function as a seamless integrated unit.

This Financial Statement also underscores our service leadership's unequivocal intent to carry Air Force Financial Management into the future with superior performance, spotless integrity and full accountability. America can be confident the Air Force Financial Management team remains steadfastly by the side of our Nation's warfighters, always dedicated to service as we "*Finance the Fight.*"

A handwritten signature in black ink, appearing to read "JGVonglis", written over a light blue background.

**John G. Vonglis**



### INTEGRITY

INTEGRITY FIRST

Integrity is the foundation of our success. It is the moral fabric that binds us together, the compass that guides us through the darkest of times. It is the promise we make to ourselves and to the world that we will do what is right, no matter the cost. Integrity is not just a word; it is a way of life. It is the strength of our character, the backbone of our values, and the cornerstone of our future. Integrity is the light that leads us home.

### SERVICE

SERVICE BEFORE SELF

Service is the heart of our mission. It is the dedication we give to our country, our community, and our fellow citizens. It is the selflessness that allows us to put the needs of others before our own. Service is the spirit that drives us to overcome the impossible and achieve the extraordinary. It is the bond that unites us and the force that propels us forward. Service is the pride of our profession, the honor of our calling, and the legacy we leave behind.

### EXCELLENCE

EXCELLENCE IN ALL WE DO

Excellence is the standard we set for ourselves. It is the pursuit of perfection, the quest for the highest quality in everything we do. Excellence is the passion that drives us to go above and beyond, to push the boundaries of what is possible. It is the pride in our work, the commitment to our craft, and the desire to be the best. Excellence is the mark of a professional, the sign of a leader, and the hallmark of a great organization.

# Management Discussion and Analysis

## Air Force Heritage



A heritage flight with a P-51 Mustang, F-15 Eagle, F-22 Raptor and A-10 Thunderbolt II fly over the crowd at the Arctic Thunder air show at Elmendorf Air Force Base, Alaska.

*“In the development of airpower, one has to look ahead and not backward and figure out what is going to happen—not too much of which has happened.”*

Brigadier General Billy Mitchell

We are America’s Airmen. We follow and celebrate the path of greatness that has led us on the course to develop the capabilities with which we fly, fight, and win. As we celebrate our 60th Anniversary, we recognize the pursuit of air and space dominance for our country was not won by words alone, but by the unending efforts of our forebears. Our mission is to deliver sovereign options for the defense of the United States and its global interests—to fly and fight in air, space, and cyberspace. We are constantly aware of our vision: Lasting Heritage...Limitless Horizons.

*“The mission is to deliver sovereign options...the subject is national investment in the strate-gic shield on which our freedoms and commerce depend.”*

Secretary of the Air Force Michael Wynne

Our core values are:

- Integrity First
- Service Before Self
- Excellence in All We Do

Our critical capabilities are:

- Global Vigilance
- Global Reach
- Global Power



OVER IRAQ -- A pair of F-16 Fighting Falcons launch flares during a mission.

Our priorities are:

- Fighting and Winning the Global War on Terror
- Developing and Caring for Our Airmen and Their Families
- Recapitalizing and Modernizing Our Aging Aircraft and Spacecraft Inventories

Our goals are:

- Foster Mutual Respect and Integrity
- Sustain Air, Space, and Cyberspace Capabilities



- Provide Persistent Situational Awareness
- Develop Joint and Battle-Ready Trained Airmen
- Improve the Total Force Quality of Life
- Implement Open, Transparent Business Practices and a Clean Audit
- Foster Air Force Smart Operations for the 21st Century (AFSO21)

A linchpin to our success, now and into the future, is the strategic foresight, accountability, and professional management of Air Force resources by our Financial Management professionals. The Air Force has recognized, most recently in the Air Force Posture Statement, that operations support functions are critical to the execution of the Air Force mission. In FY 2007, the efforts and innovation of Air Force financial management personnel continued to prove this by providing transforming efficiencies that enable Air Force priorities and support all echelons in Financing the Fight.

## Air Force in Action – FY 2007

In FY 2007, the Air Force continued to pursue, and excel in, the defense of America's interests in a historically unprecedented and dynamic strategic environment. The Air Force remained committed to and successful in achieving our top service priorities:

- Fighting and Winning the Global War on Terrorism (GWOT)
- Developing and Caring for Our Airmen and Their Families
- Recapitalizing and Modernizing Our Aging Aircraft and Spacecraft Inventories

### Fighting and Winning the GWOT

The Air Force has been in continual combat for 17 years. This continued in FY 2007 with combat operations over Iraq, clearly a critical front in the GWOT. In addition, the Air Force has been a decisive force on the Joint and coalition team in Operation Enduring Freedom in Afghanistan. America's Airmen also continued to protect and defend the skies of our Homeland in Operation Noble Eagle, now in its sixth year. We have remained committed to finding and destroying our nation's enemies wherever they seek sanctuary in our vital national struggle against violent extremism.

The Air Force operates on a global scale, 24/7. During FY 2007 on any day or time, the Air Force had 30,000 Airmen deployed to the Central Command conducting theater operations and 60,000 Airmen from Pacific Air Forces and U.S. Air Forces in Europe fully engaged in the full spectrum of dissuasion, deterrence, coalition training, and military-to-military activities.



*BAGHDAD, Iraq -- Air Force pararescuemen are extracted from an abandoned housing site via HH-60G Pave Hawk helicopter.*

These Airmen, along with those supporting them from home stations, allowed the United States to fully exploit the inherent qualities of air, space, and cyberspace operations—speed, range, and payload—and allow the deployed Air Force footprint to be smaller but vastly more flexible and lethal.

Our Airmen have excelled across the board in these demanding tasks. There is perhaps no better example than more than 7,700 Airmen fulfilling “nontraditional” ground force tasks in areas such as detainee operations, convoy operations and protection, explosive ordnance disposal, security, provincial reconstruction teams, and many other roles.

### Developing and Caring for Our Airmen and Their Families

The Air Force in FY 2007 remained a seamless Total Force, with more than 690,000 Airmen serving on Active Duty, in the Air National Guard (ANG), in the Air Force Reserve Command (AFRC), and as Air Force civilians. America’s Airmen are, simply, the bedrock of America’s ability to succeed in an era of challenge and uncertainty.

During the more than six decades of U.S. Air Force history, our Airmen have been global first responders in times of crisis due in large part to their training and dedication. In FY 2007 this trend continued, starting with an Air Force enlistee’s first day in uniform. Air Force Basic Military Training (BMT) was changed to stress an expeditionary mindset from day one.

Air Force BMT now mirrors the Air Force deployment cycle of Air Expeditionary Forces and emphasizes basic war skills and practical application throughout. We are expanding BMT by 2 weeks to provide more opportunities for field exercises, and we have instituted “Airmen’s Time” to permit veterans to mentor trainees and share their real-world experiences. During Airmen’s Time we will relate daily training to warrior and Airmanship qualities and reinforce our core values.

As Airmen progress through their careers, we have implemented a number of advanced training initiatives. The Space Professional Development Program ensures that our space operations acquisi-

tion and support personnel receive the training and experience essential to accomplish our mission in space. The U.S. Air Force Warfare Center provides advanced training to ensure that our warfighting capability remains unrivaled, including joint and combined exercises. We have also focused on important Quality of Life initiatives. The Air Force provides unequalled dining, fitness, and morale programs for our deployed Airmen, and our Learning Resource Centers provide distance learning, continued professional development, and connectivity with family and friends.



*Maj. Kevin Mountcastle talks with his family after giving them a tour of a C-130 Hercules upon arriving back home from supporting Operation Enduring Freedom.*

Another key to caring for Air Force families is our investment in military housing. In FY 2007, through military construction and housing privatization, we provided quality homes faster than ever. We are on track to eliminate all inadequate housing at overseas locations by FY 2009, and we have also focused on childcare centers, fitness centers, and dormitories for unaccompanied members.



## Recapitalizing and Modernization

*“America needs to understand that we will not win tomorrow’s fight without this recapitalization.”*

General T. Michael Moseley, Air Force Chief of Staff



*Bombers, like this B-52 Stratofortress ready to refuel from a KC-135 Stratotanker over Afghanistan, provide coalition ground forces on-demand close air support. The bomber is from the 2nd Bomb Wing at Barksdale Air Force Base, La.*

The demands of the GWOT, operations costs, fuel and many other factors continue to apply pressure on the Air Force budget. We are managing this by focusing on a “mission first” view and using tools such as Force Shaping, AFSSO21, and aircraft retirements. These enable us to operate, organize, train, and equip the Air Force to meet the demands of the future.

In light of the demands faced by America’s air and space power assets, modernization is a critical effort. It took approximately 50 years for the United States to go from humankind’s first powered flight at Kitty Hawk to testing the B-52 Stratofortress bomber. More than 50 years after that, the B-52 remains a workhorse of the Air Force. Our legacy systems have served us well and tested and proven the dedication and expertise of Airmen for decades. To ensure America’s continued dominance in air, space and cyberspace, however, we recognize that we must take concrete steps to equip our Airmen of the future.

In FY 2007, the Air Force continued to recapitalize our assets, divesting significant numbers of our oldest, least capable and most costly aircraft. To meet our 2025 force structure objectives, we must synchronize and are synchronizing this recapitalization with modernization.

The demands on air and space power for our country are many, but informed and wise modernization has proven that even with constrained resources, we can meet these demands. Examples include:

- The operational fielding of America’s Fifth Generation Fighters, the F-22A Raptor, a fighter that continues to ensure American air superiority, and the soon-to-be-fielded F-35 Lighting II, the finest multi-role fighter in the world. These aircraft will ensure America’s ability to both dominate the skies and support the range of future Joint missions.
- The outstanding continued performance of the C-17 airlifter to handle any and all demands.

*“The mission of the United States Air Force is to fly and fight, and let’s not forget this.”*

General T. Michael Moseley, Air Force Chief of Staff



*An F-22 Raptor and an F-35 Lightning II.*

- Acquisition and operations of innovative Unmanned Aerial Systems (UASs) such as the Predator, the Reaper, and Global Hawk, including standing up of the first all-UAS operational Wing in history.



*A Global Hawk unmanned system vehicle is towed back to its hangar following a mission at a deployed location in Southwest Asia. Once mission parameters are programmed into a Global Hawk, the UAS can autonomously taxi, take off, fly, remain on station capturing imagery, return and land. Ground-based operators monitor the UAS's status, and can change navigation and sensor plans during flight as necessary.*

- Leverage in cyberspace with the creation of the USAF Cyberspace Command, a partner with both Air Force Space Command and the Air Combat Command.



*Capt. Jason Simmons and Staff Sgt. Clinton Tips update anti-virus software for Air Force units to assist in the prevention of cyberspace hackers. The Air Force is setting up the Air Force Cyberspace Command soon and these Airmen will be the operators on the ground floor.*

- Recognizing and embracing the Air Force role in Joint Warfighting Integration—inherent in all we do is constant cognizance that we are part of the Joint fight. For example, Airmen are now training at the Army's National Training Center, with modernized Stryker Brigade Combat Teams, and with the Marine Corps in development of the Future Combat System.

Stated simply, the Air Force is dealing with budgetary constraints by eliminating low-leverage assets in favor of very high-leverage assets. We are focusing on these high-leverage assets, including the KC-X airborne refueling tanker, space systems, the CSAR-X (Combat Search and Rescue) system, the F-35 Lightning II Fighter and the next-generation bomber. This step is necessary to fulfill our obligation to the country to be the best possible stewards of our nation's resources. As we undertake this modernization, we are constantly cognizant of the resources entrusted to us.

The Air Force is also modernizing in other ways. During FY 2007 it became clearly—and expensively—evident that the Air Force, along with all U.S. government functions, would have to spend much more for petroleum and petroleum-based products. Within the Department of Defense (DoD), the Air Force uses proportionately the most fuel of all the Services. For every \$10 per barrel increase in petroleum, the Air Force pays more than \$600 million.

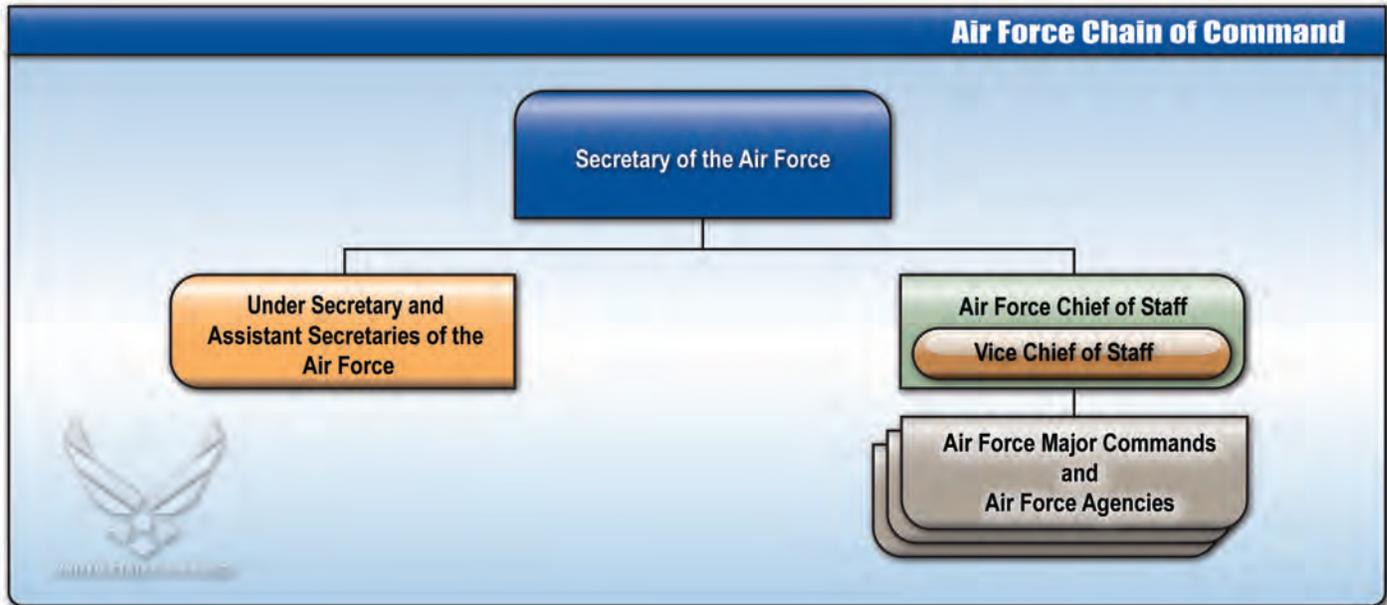
Higher fuel prices were not just recognized in expenditures and in future financial planning and budgeting, but also with strident action. The Air Force took the lead in energy conservation initiatives: using alternative fuels, implementing conservation initiatives, and promoting new technologies. We are doing these things not just for the bottom line, but because they are the right things to do. And through our leadership, the Air Force became an exemplar for all of DoD.

## Air Force Structure

The command line of the Air Force flows from the President and the National Command Authority to the Secretary of Defense and the Department of the Air Force. The Air Force is headed by the Secretary of the Air Force, with the Chief of Staff reporting to the Secretary. Immediately subordinate to the departmental headquarters are the Major Commands, Field Operating Agencies, Direct Reporting Units, and the Auxiliary.



The basic Air Force chain of command is:



## MAJOR COMMANDS (MAJCOMs)

Major Commands are primarily of two types: operational and support. Within the operational commands, the divisions are generally defined according to purpose or location (e.g., combat, movement of people and supplies, or Pacific and European theaters). The support commands generally are organized according to function (e.g., logistic, support, or training) and are directly subordinate to Air Force Headquarters. A list of the MAJCOMs and their missions follows:

American Aerospace Defense Command (NORAD). Provides support to activate USAF Cyberspace Command as a separate MAJCOM.

Command Personnel: 154,000

Primary Aircraft Inventory includes: Bombers, Fighters, Recon, ISR, and Trainers

*“Offense is the essence of airpower.”*

General H.H. “Hap” Arnold, USAAF

## AIR COMBAT COMMAND (ACC)

Missions: Operates USAF bombers (active, Air National Guard, and Air Force Reserve Command); and USAF’s CONUS-based fighter and attack, reconnaissance, battle management, and command and control aircraft and intelligence and surveillance systems. Provides combat airpower to America’s warfighting commands (CENTCOM, EUCOM, NORTHCOM, PACOM, and SOUTHCOM); nuclear, conventional, and information operations forces to STRATCOM; and air defense forces to North



OVER VIRGINIA -- Lt. Col. James Hecker flies over Fort Monroe before delivering the first operational F-22A Raptor to its permanent home at Langley Air Force Base, Va. This is the first of 26 Raptors to be delivered to the 27th Fighter Squadron.

**AIR EDUCATION AND TRAINING COMMAND (AETC)**

Missions: Recruit, train, and educate professional, expeditionary-minded Airmen to sustain the combat capability of America's Air Force. Conduct Joint, readiness, and Air Force security assistance training.



*A T-6A Texan II pilot flies in formation with another T-6A. The Texan II is replacing the T-37 Tweet as the primary trainer for Air Force pilots.*

Command Personnel: 87,000

Primary Aircraft Inventory includes: Trainers, Fighters, Transports, Helicopters, and Tankers

**AIR FORCE MATERIEL COMMAND (AFMC)**



*Airman 1st Class Marlon Wells uses a flashlight to visually inspect the avionics system in the cargo bay of a C-130 Hercules aircraft.*

Missions: Deliver warwinning expeditionary capabilities to the warfighter through development and transition of technology, professional acquisition management, and world-class sustainment of all Air Force weapons systems.

Command Personnel: 82,000

Primary Aircraft Inventory includes: Fighters, Transports, and Trainers

**AIR FORCE SPACE COMMAND (AFSPC)**

Missions: Operate and test USAF ICBM forces for STRATCOM; missile warning radars, sensors, and satellites; national space-launch facilities and operational boosters; worldwide space surveillance radars and optical systems; worldwide space environment systems; and position, navigation, and timing systems.



*A Titan IV Centaur rocket launch. The rocket is the largest unmanned space booster used by the Air Force. The vehicle carries payloads equivalent to the size and weight of those carried on the space shuttle.*

Command Personnel: 27,000

Primary Aircraft Inventory includes: Missile Warning Systems, ICBMs, Satellite Systems, and Space Surveillance Systems

**AIR FORCE SPECIAL OPERATIONS COMMAND (AFSOC)**

Missions: Serve as America's specialized air power, providing combat search and rescue and delivering special operations power anytime, anywhere. Also tasked with the seven following mission areas: Shaping the battlefield, information operations, precision engagement, SOF mobility, agile combat support, aerospace interface, and personnel recovery/recovery operations.



*Two Air Force CV-22 Ospreys prepare to land.*

Command Personnel: 13,000

Primary Aircraft Inventory includes: Helicopters, Special Operations Aircraft and Forces, and Tankers

## **AIR MOBILITY COMMAND (AMC)**

Missions: Provide rapid global mobility and sustainment through tactical and strategic airlift and aerial refueling for U.S. armed forces. Provide special duty and operational support aircraft and global humanitarian support.



*A C-17 Globemaster III conducts an assault landing.*

Command Personnel: 141,000

Primary Aircraft Inventory includes: Transports, Helicopters, and Tankers

## **PACIFIC AIR FORCES (PACAF)**

Mission: Provide ready air and space power to promote U.S. interests in the Asia-Pacific region during peacetime, crisis, and war.

Command Personnel: 46,000

Primary Aircraft Inventory includes: Fighters, Transports, and Tankers

## **U.S. AIR FORCES IN EUROPE (USAFE)**

Missions: Provide the Joint Force commander rapidly deployable expeditionary aerospace forces. Plan, conduct, coordinate and support air and space operations to achieve U.S. national and North Atlantic Treaty Organization (NATO) objectives based on U.S. European Command (EUCOM) tasks. Support U.S. military plans and operations in Europe, the Mediterranean, the Middle East, and Africa. Support activation of AFRICOM as a Unified Command with dedicated air component for Africa.



*F-15E Strike Eagles taxi to their parking spaces at Royal Air Force Base Lakenheath, England.*

Command Personnel: 33,000

Primary Aircraft Inventory includes: Fighters, Transports, and Tankers

## **AIR RESERVE COMPONENTS (AFRC)**

Missions: Support the active duty force. Serve in such missions as fighter, bomber, airlift, aerial port operations, aeromedical evacuation, aerial fire fighting, weather reconnaissance, space operations, airborne air control, flying training, fight testing, and aerial spraying. Provide support and disaster relief in the United States and support national counterdrug efforts.



*Air Force Reserve Command WC-130J Hercules, also known as a Hurricane Hunter, takes off with an aircrew from the 815th Airlift Squadron and support members from the 403rd Wing at Keesler Air Force Base, Miss.*

Command Personnel: 78,000

Primary Aircraft Inventory includes: Fighters, Transports, and Tankers

**AIR NATIONAL GUARD (ANG)**

Missions: Provide combat capability to the warfighter and security for the homeland. Protect life and property and preserve peace, order, and public safety.



*Lt. Col. Mark McCauley (from left), Col. Charles Smith and Maj. Mark Mitchum, pilots with the Virginia Air National Guard, walk to their respective F-16 Fighting Falcons for their final flight in that aircraft. They belong to the first Air National Guard unit to fly the F-22 Raptor.*

Command Personnel: 107,000

Primary Aircraft Inventory includes: Fighters, Transports, and Tankers

**FIELD OPERATING AGENCY (FOA)**

FOA is a subdivision of the Air Force and is directly subordinate to a Headquarters U.S. Air Force functional manager. An FOA performs field activities beyond the scope of any of the major commands. The activities are specialized or associated with an Air Force-wide mission and do not include functions performed in management headquarters, unless specifically directed by a DoD authority. Examples of the 32 FOAs include the Air Force Audit Agency, Air Force Communications Agency, Air Force Cost Analysis Agency, Air Force Services Agency, and Air Force Weather Agency.

**DIRECT REPORTING UNIT (DRU)**

DRU is a subdivision of the Air Force and is directly subordinate to Headquarters Air Force. A DRU performs a mission that does not fit into any of the MAJCOMs. A DRU has many of the same administrative and organizational responsibilities as a MAJCOM. The five DRUs are the Air Force Academy, Air Force Studies and Analysis Agency, Air Force Doctrine Center, Air Force District of Washington, and Air Force Operational Test and Evaluation Center.



*U.S. Air Force Academy graduates throw their hats in the air as the Air Force Thunderbirds fly overhead signaling the end of the graduation ceremony.*



### Auxiliary

An Air Force auxiliary is an organization created by statute that the Secretary of the Air Force may use to fulfill the Air Force’s noncombat programs and missions. The Civil Air Patrol (CAP) is the only U.S. Air Force auxiliary to date.



Civil Air Patrol members prepare for mission.

## Air Force Smart Operations in the 21st Century – the Way Ahead



An F-4 Phantom, P-47 Thunderbolt, F-16 Fighting Falcon and P-51 Mustang fly in a heritage flight formation.

*“Hitler built a fortress around Europe, but he forgot to put a roof on it.”*

President Franklin D. Roosevelt

The proud heritage that today’s Airmen inherit means that Air Force Financial Management professionals must embrace and manage change—a challenge they are uniquely qualified to meet. The key to this is AFSO21. Perhaps it was best summarized by the Secretary of the Air Force when he asked Airmen, “Is each task relevant, productive and value-added? In other words, is it necessary at all? With AFSO21, we will march unnecessary work out the door—forever.”

This plan—this challenge—fits Air Force Financial Management perfectly. As we found in FY 2007, America’s Airmen can redesign the way financial services are provided, reallocate staff, and improve overall services delivered ... and march unnecessary work out the door to the benefit of the American taxpayer.

### CFO Compliance

All of these Air Force Initiatives must be accomplished in accordance with applicable laws and as responsible stewards of the nation’s resources. To that end, we are focused on complete compliance with federal directives and Secretary of the Air Force guidance. To support the Air Force Chief Financial Officers Act (CFO Act) compliance goal to “Implement open, transparent business practices, and achieve a clean audit,” we initiated a financial reporting risk analysis program in compliance with Office of Management and Budget (OMB) Circular A-123, Appendix A. This program identifies and tests management’s internal controls over financial reporting and seeks to identify and correct discrepancies that could result in reporting misstatements. This initiative, coupled with our financial system compliance and data reliability efforts, as well as participation in the Office of the Under Secretary of Defense (Comptroller) Financial Improvement and Audit Readiness (FIAR) Plan, is improving the reliability of financial decision making information available to the warfighter and achieving the objectives of the CFO Act. This applies across both the General Fund of the Air Force Working Capital Fund.

After this general Air Force background, we will continue the management discussion and analysis with brief reviews of the Air Force General Fund and Working Capital Fund. These reviews will include details on Air Force stewardship of taxpayer dollars during FY 2007. The following sections will include descriptions of functional areas that these funds support and how they are used to further Air Force capabilities for the nation.

## Department of the Air Force General Fund

The General Fund is a fund in which all receipts of the United States Government are deposited, except those from specific sources required by law to be deposited into other designated funds and from which appropriations are made by Congress to carry on the general and ordinary operations of the Government. In 1990 the Chief Financial Officers Act was passed, ordering Federal agencies to centralize their finance systems to better ac-

count for their spending. In 1996, Congress passed the Federal Financial Management Improvement Act (FFMIA), enabling the advancement of Federal financial management by requiring that Federal financial management systems provide accurate, reliable, and timely financial management information to the government's managers. The most common of governmental funds are operating funds, in this case the operating funds of the Air Force are known as the General Fund. It is used to account for all financial resources except those required to be accounted for in such other funds (i.e., Working Capital Fund, addressed later in this Report).

### Air Force Resources

The three vital resources to successful accomplishment of the Air Force mission are:

- **Places:** A network of bases that reflect the Air Force's global competencies:
  - The Air Force is a global force, spanning facilities both in the United States and around the world.



*Note: Number of U.S. major Air Force installations = 72— Number of U.S. Air Force Foreign major installations = 12.  
Source: 2007 USAF Almanac, May 2007*



- **People:** Trained, motivated, and dedicated:
  - Aerospace power is a proven necessity for victory on land, at sea, in air and space, and in cyberspace. The foundation of this is our people.
  - The shift in missions to the reserve component (the Air Force Reserve and the Air National Guard) is clear. Indeed, without these “hometown warriors,” the Air Force could not complete our full range of necessary missions.
- **Systems:** Modern weapons platforms that integrate air, space, and cyber assets into an undefeatable force:
  - To the Air Force, “systems” no longer means just “manned aircraft.” They mean space launch vehicles, satellites, intelligence surveillance and reconnaissance (ISR) assets, unmanned aerial systems (UASs), and the cohesive infra structure to make the “system” an asset for Air Force people to accomplish the Air Force and joint mission.

## Air Force Strategic Financial Management and Transformation

To accomplish Air Force goals and realize the Air Force vision, Air Force Financial Management (SAF/FM) is setting the pace for transformation across the entire Air Force. The strategic vision for SAF/FM entails moving the career field away from transaction processing toward greater decision support and enhanced strategic advice to commanders. The vehicle for realizing this vision is the single largest change effort in SAF/FM history. The phases of FM Transformation primarily focus on revolutionizing the core financial functions, changing the behavior and capabilities of the financial personnel performing those functions, establishing on-demand support services, realigning and integrating the Air Force Accounting and Budget offices, modifying design support systems and programs, creating training materials and programs (including Web-based training tools), and establishing a continuous cultural improvement program to achieve the transformation to a world-class operation.

In FY 2007, SAF/FM created a road map through our FY 2007–2012 Strategic Plan that translates our vision into concrete, actionable, and measurable steps. It integrates ongoing transformation initiatives into strategy and communicates priorities, focuses efforts, and serves as a filter to help determine where to invest time, people, and resources.

The strategic goals outlined in the Strategic Plan are:

- Foster mutual respect and integrity
- Reduce Air Force cost structure
- Expand partnership in strategic Air Force decisions
- Recruit, prepare, and retain a well-trained and highly educated professional team for today and tomorrow
- Provide our customers with world-class financial services
- Implement open, transparent business practices and achieve a clean audit
- Continuously streamline financial management processes and increase capabilities

To better achieve these goals, FM is transforming—in the same manner as the entire Air Force—our systems, people, and services.

**Systems:** Critical financial Information Technology systems will continue to be modernized, streamlined, and implemented to efficiently provide timely, accurate business intelligence. Revolutionary systems such as the Defense Integrated Military Human Resources System (DIMHRS), which will reduce manpower, time, and resources needed to provide financial and personnel support, are being implemented to support the warfighter. Defense Enterprise Accounting and Management System (DEAMS) is transforming Air Force accounting using industry’s best practices to provide improvements in quality, flexibility, accountability, speed, and accuracy.

A pilot version of new technology-driven budget formulation software will demonstrate increased capabilities and integration. Continued efforts to update systems such as these are creating a foundation for the future in Financing the Fight.

**People:** The FM workforce is critical to leveraging these systems and achieving FM's strategic goals. The FM Airmen—officer, enlisted, and civilian; active, reserve, and guard—provide valuable, accurate, and timely financial services to enable FM's tactical, operational, and strategic force development to provide the right training to the right person at the right time. FM's Career Field Managers are adjusting education curricula to accommodate changes in the career field and supplementing existing courses to maximize training opportunities. We will continue to develop the FM workforce as they enable us to attain our goals.

**Services:** Services transformation comprises work streams, also known as Lanes of Transformation, and report to the Director of Strategic Planning and Transformation (SAF/FMT). These lanes are inextricably linked to both people and systems, completing the overall transformation effort for Air Force FM. In 2007, the lanes shifted focus to concentrate on enhancing AF-wide business processes and practices for the following upcoming initiatives:

- **Financial Services Delivery Model:** This model and our adherence to it is responsible for consolidating and transforming the FM career field through the establishment of the Air Force Financial Services Center (AFFSC) at Ellsworth AFB, SD. The delivery model for finance operations is a two-phased approach. Phase I will consolidate back-office military and travel pay processing for Active and Reserve bases into one location called the Central Processing Center, which opened in September 2007. This effort will align remaining base processes with those that migrate to the center. Phase II consists of the transition to a 3-tier customer service concept, which includes a 24/7 Call Center, online services, and face-to-face support, allowing customers to get finance help anytime and anywhere in the world. The AFFSC has already opened and will become fully operational in October 2008.
- **Decision Support:** The Decision Support team has made great strides in shifting the focus of financial managers from transactional work to decision support by providing the FM community with enhanced financial training, improved processes, and a refo-cused organizational structure at the base level. The team remains focused on supporting career field managers in identifying the necessary skills and capabilities to provide enhanced decision support and delivering the appropriate training to achieve the FM vision.
- **Strategic Communications:** The development of our Strategic Plan looking toward 2008 meant greater focus on our Strategic Communications team, which was turned into a specific lane. The Strategic Communications lane is responsible for marketing Financial Management Transformation to the rest of the Air Force through dynamic and informative materials as well as documenting transformation successes.
- **Air Force Smart Operations for the 21st Century (AFSO21):** AFSO21 is responsible for identifying opportunities and leading efforts to improve processes. Through lean practices to eliminate waste and increase operational support, the AFSO21 team is helping the Air Force better manage its financial resources.
- **Education and Training Transformation:** This lane provides the training strategies and materials needed to implement the other lanes of transformation. Working under Career Field Manager guidance, the Education and Training team is developing Web-based training tools, updating procedures manuals, and revamping classroom curricula. These are just a few of the actions undertaken by this lane to ensure that FM



*Deployed USAF Finance office.*



personnel have the skills necessary to perform their duties in the transformed environment.

- **Budget Transformation Operation:** The goal of this lane is to create a world-class operation in the Headquarters Air Force Budget Operations Office (SAF/FMBO) by strategically allocating resources, reengineering processes, and building continuous cultural improvements.

## **Transformation accomplishments in FY 2007 included:**

- The AFFSC is on track for completion and opened its doors September 2007; the initial cadre has arrived at Ellsworth AFB, SD. The AFFSC teams have also completed (and continue to complete) cutover site awareness visits to all Air Force bases. Additionally, the Contact Center development is moving forward and is on target to open in October 2008.



*Secretary of the Air Force Michael W. Wynne and John Vonglis are briefed on the new Air Force Financial Services Center operations at Ellsworth Air Force Base, S.D.*

- The AFSO21 lane began operations in October 2006. Since then, the team has held numerous continual process improvement events encompassing transparency, decision support, and customer support processes. This progress has helped enable the Air Force and SAF/FM in their efforts to revitalize the Air Force weapon system inventory.

- The Decision Support team completed the realignment of base financial personnel, delivered core accounting and budget training, developed improved civilian personnel documents for enhanced career advancement, and delivered a “Roadmap to Decision Support” to articulate the FM Strategic Vision of providing financial analysis and decision support to commanders.
- The Analytical Capability Transformation team opened the Financial Management Center of Expertise (COE) on April 18, 2006, to offer on-demand, specialized financial analysis for O&M decision support to bases and MAJCOMs. The COE is on track and became fully operational in 2007. SAF/FMT has turned it over to the Deputy Assistant Secretary for Cost and Economics, SAF/FMC.
- The Education, Training, and Development team has been working to institutionalize decision support training and education into the development of the FM Force. The team provided direct support to FM transformation efforts by developing enhanced, Web-based training and education; it has provided thought leadership and delivered results that expanded and enhanced the relevance of training provided to all FM personnel. Additionally, the team created more than 100 new Web-based courses.
- The Strategic Communications team produced multiple products to market Financial Management’s transformation. Some examples include the creation and dissemination of brochures, newsletters, briefs, flash pieces, and events (e.g., Financial Management Executive Session and Professional Development Institute tradeshow booth).
- The Budget Transformation Operation (BTO) team was successful in evolving the budget execution process by eliminating the cumbersome financial plan and replacing it with a streamlined execution plan. Additionally, their efforts are changing a culture by shifting focus from being reactive information providers to proactive problem solvers. The BTO lane is also fully engaged in redoing the funding process and justification books.

- A state-of-the-art financial management system that serves the Air Force and U.S. Transportation Command came to fruition on August 3, 2007, when the DEAMS Increment 1 was successfully fielded at Scott AFB, Ill. DEAMS will replace several antiquated systems, considerably reducing the time to process and track financial transactions.
- These transformation efforts are enabling us to change the way FM does business in order to meet the current challenges and needs of the Air Force.

### Objective of Internal Controls

Air Force Financial Management Transformation, however, must be based on management integrity. To this end, we have put in place robust internal controls. The objectives of the system of internal accounting and administrative control of the Department of the Air Force are to provide reasonable assurance that:



*Mr. John Vonglis, the Principal Deputy Assistant Secretary of the AF (FM), poses with the staff of the Realigned ALO-FMA at Offutt AFB.*

- Obligations and costs comply with applicable law.
- Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, and misappropriation.
- Revenues and expenditures applicable to Air Force operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statisti-

cal reports, and to maintain accountability over the assets, including nonappropriated fund activities.

- Programs and administrative and operating functions are efficiently and effectively carried out in accordance with applicable law and management policy.
- The internal control process emphasized prevention of waste, fraud, and mismanagement along with timely correction of internal control weaknesses.

### Internal Control Program Accomplishments and Highlights

The Federal Managers' Financial Integrity Act (FMFIA) implementation in the Air Force rests on a solid general control environment supported by positive endorsement from top management. FY 2007 was a year of strong internal control activity as our financial managers continued to integrate their job oversight responsibilities with the internal control program's evaluation procedures. Using pervasive technologies, Air Force Major Commands increased distribution of internal control information on their force-wide available Web sites. For example, the Air Force Space Command established an Internal Control Program Web page on the Air Force Portal that provides links to applicable regulations, document templates, a 27 page PowerPoint training briefing, and a by-name list of internal control program coordinators for the centers, wings, and headquarters. The Web page is continuously updated to ensure that its content is both current and user friendly. This site provides every level throughout the command with the tools needed to manage and assess controls. This training has increased program awareness, reduced training expenses, enhanced efficiency, and gained the active participation of personnel at all levels.

During FY 2007, we continued to implement new program requirements directed in DOD Instruction 5010.40, Managers' Internal Control Program Procedures, in response to revised guidance in OMB Circular A-123, Management's Responsibility for Internal Control. The revised guidance included additional requirements to specifically address establishing and assessing



internal controls over financial statement reporting. It also required the establishment of a senior assessment team to provide direction and oversight for the assessments. The Office of the Under Secretary of Defense/Comptroller (OUSD/C) directed that our review encompass specific key focus areas material to DoD and the effectiveness of key business process internal controls, which significantly affect financial reports. During this year we documented the required processes, performed risk analysis, developed swim-lane flowcharts, and analyzed existing internal controls for the required focus areas. Based on this year's review effort, we identified seven material weaknesses that were briefed to the Air Force Senior Assessment Team and approved to be included in the Secretary's Annual Statement of Assurance. The specific focus areas we documented will grow through a continuous cycle; new areas included each fiscal year until all financial statements and the processes throughout financial reporting are included. For more about these efforts, we will next look at the operations and efficiencies of the Air Force Working Capital Fund.

## Air Force Working Capital Fund



*Airman 1st Class Mark Drennen checks an AIM-120 missile on an F-16 Fighting Falcon.*

The Air Force Working Capital Fund (AFWCF) is a revolving fund established to meet the diverse weapon system sustainment requirements for the Air Force, Army, Navy and Foreign Military operating forces. Under the revolving fund concept, an appropriation or transfer of funds finances initial AFWCF operations. General/appropriated fund payments from customers for goods delivered or services performed subsequently replenish this initial working capital investment and sustain a continuous cycle of operations, minimizing the need for additional annual appropriations from Congress.

### Air Force Working Capital Fund (WCF) Overview

Air Force Materiel Command (AFMC) supports Air Force warfighters and operations via four major business areas that operate as revolving funds, (i.e., providers charge users for the goods and services provided). AFMC accounts for more than 90 percent of WCF revenue and expense activity (excluding the Transportation WCF, which is managed by the United States Transportation Command). The AFMC managed WCF consists of two functions: Supply Management and Depot Maintenance. These functions, referred to as activity groups, supply singular goods and services to Air Force and Department of Defense (DoD) customers as well as customers outside the DoD, such as local and foreign governments. Supply Management expedites repair, replenishment, and inventory control for spare parts and associated logistics support services to fulfill AF needs during war and peacetime. Depot Maintenance provides economical and responsive repair, overhaul, and modification of aircraft, missiles, engines, and other major end items and associated components. The Information Services business area was closed effective March 31, 2007, and no longer operates under the WCF.

WCFs allow the Air Force to accomplish the following:

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

## Supply Management Activity Group

The Supply Management Activity Group (SMAG) provides policy, guidance, and resources to meet Air Force needs for spare parts. SMAG manages approximately 2 million items including weapon systems spare parts, medical/dental supplies and equipment, and items used for non-weapon systems applications. Material procured from vendors held in inventory is for sale to authorized customers. The SMAG consists of four divisions: Material Support Division (MSD), General Support Division (GSD), Medical/Dental Division, and United States Air Force Academy Cadet Issue Division. AFMC manages MSD and GSD. Headquarters, United States Air Force, manages the Medical/Dental Division and the Air Force Academy Cadet Issue Division.

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



*The U.S. Air Force Demonstration Squadron, "Thunderbirds."*

The WCF Retail Operations consist of the General Support, Medical/ Dental, and United States Air Force Academy divisions. Although each division operates independently, all purchase large quantities of commodities in order to sell small quantities directly to the ultimate consumer—the warfighter. Large bulk buys allow the Air Force to take advantage of economies of scale and achieve

significant cost savings. Additionally, each division concentrates its efforts in a specific area of expertise.

The GSD items support installation maintenance, administrative functions, and field and depot maintenance of aircraft and other systems. GSD supports AF installations throughout the world.

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

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

### Customers, Products, and Services

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

### SMAG Transformation Initiatives

The AF has undertaken a fundamental redesign of supply chain management processes as part of the Expeditionary Logistics for the 21st Century (eLog21) effort to transform AF logistics. SMAG processes have been, and will continue to be, profoundly impacted as previous Purchasing and Supply Chain Management (PSCM) and Weapon System Supply Chain Management (WSSCM) initiatives are woven into an overarching strategy to transform organizations, processes, and information technology supporting warfighter supply



requirements. HQ USAF leads the process of defining and implementing an enterprise resource planning tool under the Expeditionary Combat Support System (ECSS) development. And AFMC is charged with heading up the formation of the Global Logistics Support Center (GLSC) and the Centralized Asset Management (CAM) office, both of which will centralize key resource planning and execution processes with the goal of bringing an enterprise perspective to weapon system sustainment activities. The major pillars of the AF's supply chain transformation are briefly described below.

- eLog21 is the AF logistics road map to transformation and offers vast improvements to the effectiveness (and costs) associated with logistics support to combat forces. Through eLog21, AF leaders aim to cut across stovepipes, eliminating burdensome legacy processes and systems used AF-wide. The eLog21 vision is to provide an integrated AF-wide logistics system that delivers consistent capabilities to the warfighter in a flexible, scalable, modular, and expeditious manner; a system that exploits our nation's total capabilities in the most cost-effective manner.
- ECSS is a commercial off-the-shelf (COTS)-based technology solution that will enable a seamless flow of information across the entire AF logistics community through a comprehensive set of integrated IT modules. ECSS will create an AF-wide solution that exploits current technology and creates an integrated data environment. It will consist of separate but integrated modules ranging from finance and purchasing to order management and bill of materials as well as other logistics functions—all accessible via the AF portal. ECSS will be a critical enabler for the GLSC when fully operational.
- The AF GLSC will own the USAF supply chain. GLSC's mission is to merge wholesale and retail logistics as well as integrate and oversee all logistics processes, technology, and resources in order to deliver end-to-end supply chain management capabilities to the warfighter. While GLSC organizational structure and relationships are still being

discussed, the CSAF decided that the GLSC will be a direct reporting unit under the AFMC commander, and high-level GLSC functions have been documented in AF Program Action Directive 07-01.



*Staff Sgt. Shannon Hughes (left) hands Senior Airman Damon Johnson a tool as they work on an A-10 Thunderbolt II during its phase inspection.*

## Customer Support Performance Measures

Mission Capable (MICAP) and Customer Wait Time (CWT) measures allow managers to assess the quality of spares support provided and plan corrective action when needed. MICAP hours are accrued when a weapon system's mission capability is affected by parts that are on backorder to a wholesale source of supply. For every day during the month that the requisition is unfilled, 24 hours are assigned to the requisition. CWT measures the average time elapsed—expressed in days—between customer order and satisfaction of that order, including the wait time backorder. MICAP hours for AFMC-managed items have improved significantly since 1999. MSD items accrued an average of 5 million monthly MICAP hours during calendar year 2000. That number dropped to 1.3 million hours for the 12 month period ending in April 2007. CWT is a newer metric, but has also shown a significant improvement. The monthly average CWT for MSD items during FY 2004 was 7.4 days. For the period from May 2006 to April 2007, the number dropped to 5.5 days.

## 2007 Financial Performance Measures

SMAG measures financial performance based on the Net Operating Result (NOR) for MSD and GSD. The NOR is the difference between revenue and expenses, i.e., a bottom-line profit and loss indicator. The NOR objective of an activity group is to break even over the budget cycle. Setting rates that effectively offset prior year net profit or loss and break even for new activity in the rate-setting year accomplishes this objective. Revenues are amounts earned as a result of normal operations and usually derive from sale of, or reimbursements for, goods and services provided to DoD activities, other federal government agencies, and the public. Expenses are the use of resources during an accounting period in carrying out the DoD's mission. The objective is to provide needed goods and services to customers while generating the revenue required to sustain continued operations within the activity.

## Depot Maintenance Activity Group

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



*Depot-level maintenance on a KC-135 Airframe.*

## Customers, Products, and Services

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

DMAG supports a variety of customers including Air Force Major Commands, Air National Guard (ANG), Air Force Reserve Command (AFRC), SMAG, Foreign Military Sales, and non-DoD customers. Additionally, DMAG provides storage, reclamation, and regeneration of equipment not currently used by the military services. This work is done at the Aerospace Maintenance and Regeneration Group at Davis-Monthan AFB, Arizona. Contract depot maintenance is transitioning from the AFWCF to be financed directly by the using commands, SMAG, and other customers.

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

## Transformation Initiatives

As pointed out previously, AFSO21 is the overarching program to facilitate the process improvement culture that encompasses all transformation efforts. Process improvement activities have reduced flow days and backlogs and have avoided costs, thus increasing equipment availability to the warfighter and reducing



operating costs in support of eLog21 and Aircraft Availability Improvement Program (AAIP) goals. AAIP identifies airframe-specific goals for availability and cost and identifies supporting improvement initiatives. Developed by the System Program Manager in partnership with the Lead MAJCOMs, AAIP plans are a collection of initiatives with sponsors from across the Air Force all focused on improving availability and reducing cost.

The primary improvement methodologies have been Lean and Critical Chain Project Management (CCPM). These methodologies have been the main enablers in reducing backlogs through eliminating waste and increasing flow. CCPM has reduced aircraft flow days in Programmed Depot Maintenance (PDM) through better management of resources and schedule times.

Additionally, DMAG has been actively supporting SMAG through initiatives such as GLSC and Repair Enterprise 21 (RE21). RE21 is an enterprise-wide, single repair network supporting a single supply chain through centralizing intermediate repair; it will be managed through GLSC.

## Customer Support Performance Measures

Customer support performance measures for DMAG consist primarily of production performance measures which are used to assess cost, schedule, and quality of the DMAG output. We have designed these measures to achieve accountability at the appropriate depot maintenance level—the Depot Maintenance Manager. Customer support performance measures monitor progress toward DMAG goals.



*Tech. Sgt. Rosits, a member of the 332nd Air Expeditionary Wing honor guard, holds the American flag during a change-of-command at Balad Air Base, Iraq.*

The Due Date Performance (the ability of the depot to provide aircraft on time) is currently exceeding the standard of 95 percent, holding at 97 percent as of June 2007. The depot performance of Air Logistics Centers (ALCs) continues to have a direct impact on the warfighter's ability to meet worldwide missions.

## Financial Performance Measures

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

## Cash Management

DoD cash management policy recommends maintaining the minimum cash balance necessary to meet both operational requirements and disbursements in support of the capital program. Cash generated from operations is the primary means of maintaining adequate cash levels. Effective cash management depends directly on the availability of accurate and timely data on cash levels and operational results. Cash levels should be maintained to cover at least 7 to 10 days of operational costs as well as levels adequate to meet 6 months of capital disbursements.

Cash management efforts continue to focus on analyzing data, developing tools to identify changes in cash, and forecasting future needs for cash. Each month, AFMC prepares a statement of sources and uses of cash. These statements are used to identify areas of cash increases and drains to monitor performance against the recommended policy.

## Centralized Asset Management (CAM) and Global Logistics Support

CAM is focused on improving how AF manages sustainment resources across the enterprise. It will optimize support in steady state and expeditionary operations. Under the CAM construct, AFMC will assume planning, programming, budgeting, and execution responsibility for Depot Purchased Equipment Maintenance (DPEM), Depot-Level Repairable (DLR), Sustainment Engineering (Sust Eng), Technical Orders (TOs), Contractor

Logistics Support (CLS), Aviation Petroleum Oil and Lubricants (AVPOL), Flying Hour (FH) Consumables, and Support Equipment (Supp Equip).

*“Air dominance is something we earned for the last 50 years, and we intend to retain it.”*

Secretary of the Air Force Michael Wynne

## Financing the Fight

We face an uncertain world with asymmetric threats to our sovereignty and security. We must come to accept that the technology as well as the manner and means of warfighting in defense of America are changing, and that the changes are not gradual but exponential. This is particularly true of understanding air, space, and cyberspace power. As we survey the past, consider this: The then-Army Signal Corps purchased its first airplane in 1905. By

1917, U.S. aircraft were flying in combat. Within 25 years, all of the magnificent aircraft that would win all of the air wars of World War II were operational. And less than 15 years after that, the very first uniquely US Air Force airplanes, both what we now know as the C-130 and the B-52, were flying—as they are today. In 1958, no American had been in space, but of course by 1969 we had put men on the moon.

Today we must—for our troops on the ground and in the larger sense for the security of our country—dominate air, space, and cyberspace. This requires not gradual, linear change but innovative and constant transformation. The entire Air Force is called upon to undertake this challenge, and America’s Airmen are responding with characteristically stellar performance.

Enabling our Airmen also requires the greatest and most effective use of the resources of this great country. Air Force Financial Management professionals bear this in mind around the world, day and night. They are the best stewards of those resources that could be wished by any country at any time. They are, indeed, *Financing the Fight*.



*An E-3 Sentry Airborne Warning and Control System sits on the flightline at a forward-deployed location in Southwest Asia.*

A night photograph of the United States Air Force Memorial. The monument's three large, curved, metallic arches are illuminated from below, creating a warm glow. In the foreground, a stone wall features the inscription "THE UNITED STATES AIR FORCE MEMORIAL" in gold lettering. The sky is filled with a large, vibrant firework display, with numerous bright streaks of light in shades of yellow, orange, and red. A small, illuminated structure is visible in the lower right corner.

THE UNITED STATES  
AIR FORCE MEMORIAL



# Fiscal Year 2007

## Annual Financial Statements



## **Limitations to the Financial Statements**

The principal financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of Title 31, United States Code, Section 3515 (b). While the statements have been prepared from the books and records of the entity, in accordance with Generally Accepted Accounting Principles for Federal entities and the formats prescribed by Office of Management and Budget, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

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# General Fund Principal Statements

## Fiscal Year 2007

The FY 2007 Department of the Air Force General Fund Principal Statements and related notes are presented in the format prescribed by the Department of Defense Financial Management Regulation 7000.14-R, Volume 6B. The statements and related notes summarize financial information for individual activity groups and activities within the General Fund for the fiscal year ending September 30, 2007, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2006.

The following statements comprise the Department of the Air Force General Fund Principal Statements:

- Consolidated Balance Sheet

The Consolidated Balance Sheet presents as of September 30, 2007 and 2006 those resources owned or managed by the Air Force which are available to provide future economic benefits (assets); amounts owed by the Air Force that will require payments from those resources or future resources (liabilities); and residual amounts retained by the Air Force, comprising the difference (net position).

- Consolidated Statement of Net Cost

The Consolidated Statement of Net Cost presents the net cost of the Air Force's operations for the years ended September 30, 2007 and 2006. The Air Force's net cost of operations includes the gross costs incurred by the Air Force less any exchange revenue earned from Air Force activities.

- Consolidated Statement of Changes in Net Position

The Consolidated Statement of Changes in Net Position presents the change in the Air Force's net position resulting from the net cost of Air Force's operations, budgetary financing sources other than exchange revenues, and other financing sources for the years ended September 30, 2007 and 2006.

- Combined Statement of Budgetary Resources

The Combined Statement of Budgetary Resources presents the budgetary resources available to the Air Force during FY 2007 and 2006, the status of these resources at September 30, 2007 and 2006, and the outlay of budgetary resources for the years ended September 30, 2007 and 2006.

The Principal Statements and related notes have been prepared to report financial position pursuant to the requirements of the Chief Financial Officers Act of 1990, the Government Management Reform Act of 1994, and the Office of Management and Budget's Circular A-136, "Financial Reporting Requirements."



## Consolidated Balance Sheet - General Fund

As of September 30, 2007 and 2006 (\$ in thousands)

	2007 Consolidated	2006 Consolidated
<b>1. ASSETS (NOTE 2)</b>		
A. Intragovernmental:		
1. Fund Balance with Treasury (Note 3)		
a. Entity	\$ 80,031,552	\$ 68,767,178
b. Non-Entity Seized Iraqi Cash	0	0
c. Non-Entity-Other	94,844	80,989
2. Investments (Note 4)	823	722
3. Accounts Receivable (Note 5)	388,823	665,672
4. Other Assets (Note 6)	423,952	454,968
5. Total Intragovernmental Assets	\$ 80,939,994	\$ 69,969,529
B. Cash and Other Monetary Assets (Note 7)	\$ 107,908	\$ 114,779
C. Accounts Receivable, Net (Note 5)	545,796	1,041,746
D. Loans Receivable (Note 8)	0	0
E. Inventory and Related Property, Net (Note 9)	46,335,059	48,584,335
F. General Property, Plant and Equipment, Net (Note 10)	143,257,880	141,861,111
G. Investments (Note 4)	0	0
H. Other Assets (Note 6)	10,448,818	11,379,126
<b>2. TOTAL ASSETS</b>	<b>\$ 281,635,455</b>	<b>\$ 272,950,626</b>
<b>3. LIABILITIES (NOTE 11)</b>		
A. Intragovernmental		
1. Accounts Payable (Note 12)	\$ 1,509,631	\$ 1,425,771
2. Debt (Note 13)	0	0
3. Other Liabilities (Note 15 & 16)	2,033,326	2,258,259
4. Total Intragovernmental Liabilities	\$ 3,542,957	\$ 3,684,030
B. Accounts Payable (Note 12)	\$ 3,189,763	\$ 4,269,732
C. Military Retirement and Other Federal Employment Benefits (Note 17)	1,137,016	1,143,748
D. Environmental and Disposal Liabilities (Note 14)	6,898,867	6,554,952
E. Loan Guarantee Liability (Note 8)	0	0
F. Other Liabilities (Note 15 & Note 16)	6,081,496	6,253,108
<b>4. TOTAL LIABILITIES</b>	<b>\$ 20,850,099</b>	<b>\$ 21,905,570</b>
<b>5. NET POSITION</b>		
A. Unexpended Appropriations - Earmarked Funds (Note 23)	\$ 0	\$ 0
B. Unexpended Appropriations - Other Funds	80,465,487	70,186,333
C. Cumulative Results of Operations - Earmarked Funds	4,548	4,540
D. Cumulative Results of Operations - Other Funds	180,315,321	180,854,183
<b>6. TOTAL NET POSITION</b>	<b>\$ 260,785,356</b>	<b>\$ 251,045,056</b>
<b>7. TOTAL LIABILITIES AND NET POSITION</b>	<b>\$ 281,635,455</b>	<b>\$ 272,950,626</b>

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

## Consolidated Statement of Net Cost - General Fund

As of September 30, 2007 and 2006 (\$ in thousands)

	2007 Consolidated	2006 Consolidated
	<hr/>	<hr/>
<b>1. Program Costs (Note 18)</b>		
A. Gross Costs	\$ 142,462,370	\$ 142,378,997
B. (Less: Earned Revenue)	-5,715,540	-5,320,847
C. Net Program Costs	<hr/> \$ 136,746,830	<hr/> \$ 137,058,150
<b>2. Cost Not Assigned to Programs</b>	0	0
<b>3. (Less: Earned Revenue Not Attributable to Programs)</b>	0	0
<b>4. Net Cost of Operations</b>	<hr/> <b>\$ 136,746,830</b> <hr/>	<hr/> <b>\$ 137,058,150</b> <hr/>

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



## Consolidated Statement of Changes in Net Position - General Fund

As of September 30, 2007 and 2006 (\$ in thousands)

	2007 Earmarked Funds	2007 All Other Funds	2007 Eliminations
<b>CUMULATIVE RESULTS OF OPERATIONS (Note 19)</b>			
<b>1. Beginning Balances</b>	\$ 4,540	\$ 180,854,184	\$ 0
<b>2. Prior Period Adjustments</b>			
A. Changes in accounting principles (+/-)	0	0	0
B. Corrections of errors (+/-)	0	0	0
<b>3. Beginning balances, as adjusted</b>	\$ 4,540	\$ 180,854,184	\$ 0
<b>4. Budgetary Financing Sources</b>			
A. Other adjustments (rescissions, etc.)	0	0	0
B. Appropriations used	0	136,203,035	0
C. Nonexchange revenue	928	5	0
D. Donations and forfeitures of cash and cash equivalents	1,843	0	0
E. Transfers-in/out without reimbursement	0	282,000	0
F. Other budgetary financing sources	0	0	0
<b>5. Other Financing Sources</b>			
A. Donations and forfeitures of property	0	0	0
B. Transfers-in/out without reimbursement (+/-)	0	261,389	0
C. Imputed financing from costs absorbed by others	0	724,671	0
D. Other (+/-)	0	-1,265,895	0
<b>6. Total financing Sources</b>	\$ 2,771	\$ 136,205,205	\$ 0
<b>7. Net Cost of Operations (+/-)</b>	2,765	136,744,066	0
<b>8. Net Change</b>	6	-538,861	0
<b>9. Cumulative Results of Operations</b>	4,546	180,315,323	0
<b>UNEXPENDED APPROPRIATIONS</b>			
<b>10. Beginning Balances</b>	\$	\$ 70,186,334	\$ 0
<b>11. Prior Period Adjustments</b>			
A. Changes in accounting principles	0	0	0
B. Corrections of errors	0	0	0
<b>12. Beginning balances, as adjusted</b>	\$ 0	\$ 70,186,334	\$ 0
<b>13. Budgetary Financing Sources</b>			
A. Appropriations received	0	147,671,923	0
B. Appropriations transferred-in/out	0	579,271	0
C. Other adjustments (recissions, etc)	0	-1,769,006	0
D. Appropriations used	0	-136,203,035	0
<b>14. Total Budgetary Financing sources</b>	0	10,279,153	0
<b>15. Unexpended Appropriations</b>	0	80,465,487	0
<b>16. Net Position</b>	\$ 4,546	\$ 260,780,810	\$ 0

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

2007 Consolidated	2006 Earmarked Funds	2006 All Other Funds	2006 Eliminations	2006 Consolidated
\$ 180,858,724	\$ 5,451	\$ 161,338,650	\$ 0	\$ 161,344,101
0	0	0	0	0
0	0	19,309,311	0	19,309,311
<u>\$ 180,858,724</u>	<u>\$ 5,451</u>	<u>\$ 180,647,961</u>	<u>\$ 0</u>	<u>\$ 180,653,412</u>
0	0	0	0	0
136,203,035	-1,251	132,720,187	0	132,718,936
933	877	0	0	877
1,843	1,779	0	0	1,779
282,000	0	106,784	0	106,784
0	0	0	0	0
0	0	0	0	0
261,389	0	46,239	0	46,239
724,671	0	698,815	0	698,815
-1,265,895	0	3,690,030	0	3,690,030
<u>\$ 136,207,976</u>	<u>\$ 1,405</u>	<u>\$ 137,262,055</u>	<u>\$ 0</u>	<u>\$ 137,263,460</u>
<u>136,746,831</u>	<u>2,316</u>	<u>137,055,834</u>	<u>0</u>	<u>137,058,150</u>
<u>-538,855</u>	<u>-911</u>	<u>206,221</u>	<u>0</u>	<u>205,310</u>
<u>180,319,869</u>	<u>4,540</u>	<u>180,854,182</u>	<u>0</u>	<u>180,858,722</u>
\$ 70,186,334	\$ -1,251	\$ 63,717,889	\$ 0	\$ 63,716,638
0	0	0	0	0
0	0	0	0	0
<u>\$ 70,186,334</u>	<u>\$ -1,251</u>	<u>\$ 63,717,889</u>	<u>\$ 0</u>	<u>\$ 63,716,638</u>
147,671,923	0	139,764,959	0	139,764,959
579,271	0	2,469,906	0	2,469,906
-1,769,006	0	-3,046,233	0	--3,046,233
-136,203,035	1,251	-132,720,187	0	-132,718,936
10,279,153	1,251	6,468,445	0	6,469,696
80,465,487	0	70,186,334	0	70,186,334
<u><b>\$ 260,785,356</b></u>	<u><b>\$ 4,540</b></u>	<u><b>\$ 251,040,516</b></u>	<u><b>\$ 0</b></u>	<u><b>\$ 251,045,056</b></u>

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



## Combined Statement of Budgetary Resources - General Fund

As of September 30, 2007 and 2006 (\$ in thousands)

	2007 Combined	2006 Combined
<b>BUDGETARY FINANCING ACCOUNTS (Note 20)</b>		
<b>BUDGETARY RESOURCES:</b>		
1. Unobligated balance, brought forward, October 1	\$ 17,112,927	\$ 13,006,208
2. Recoveries of prior year unpaid obligations	3,921,941	1,450,906
3. Budget authority		
A. Appropriation	147,674,697	139,767,610
B. Borrowing authority	0	0
C. Contract authority	0	0
D. Spending authority from offsetting collections		
1. Earned		
a. Collected	10,237,677	9,255,190
b. Change in receivables from Federal sources	-517,749	-99,279
2. Change in unfilled customer orders		
a. Advance received	376,618	-94,677
b. Without advance from Federal sources	250,810	-102,493
3. Anticipated for rest of year, without advances	0	0
4. Previously unavailable	0	0
5. Expenditure transfers from trust funds	0	0
E. Subtotal	\$ 158,022,053	\$ 148,726,351
4. Nonexpenditure transfers, net, anticipated and actual	861,271	2,576,690
5. Temporarily not available pursuant to Public Law	0	0
6. Permanently not available	-1,769,006	-3,046,233
<b>7. Total Budgetary Resources</b>	<b>\$ 178,149,186</b>	<b>\$ 162,713,922</b>
<b>STATUS OF BUDGETARY RESOURCES:</b>		
8. Obligations incurred:		
A. Direct	\$ 146,524,833	\$ 136,439,546
B. Reimbursable	10,449,009	9,161,449
C. Subtotal	156,973,842	145,600,995
9. Unobligated balance:		
A. Apportioned	18,573,839	14,998,616
B. Exempt from apportionment	3,271	3,174
C. Subtotal	18,577,110	15,001,790
10. Unobligated balance not available	2,598,234	2,111,137
<b>11. Total status of budgetary resources</b>	<b>\$ 178,149,186</b>	<b>\$ 162,713,922</b>
<b>CHANGE IN OBLIGATED BALANCE:</b>		
12. Obligated balance, net		
A. Unpaid obligations, brought forward, October 1	53,989,101	51,840,781
B. Less: Uncollected customer payments from Federal sources, brought forward, October 1	\$ -2,633,723	\$ -2,835,497
C. Total unpaid obligated balance	51,355,378	49,005,284
13. Obligations incurred net (+/-)	\$ 156,973,842	\$ 145,600,995
14. Less: Gross outlays	-146,107,640	-142,001,769
15. Obligated balance transferred, net		
A. Actual transfers, unpaid obligations (+/-)	0	0
B. Actual transfers, uncollected customer payments from Federal sources (+/-)	0	0
C. Total Unpaid obligated balance transferred, net	0	0
16. Less: Recoveries of prior year unpaid obligations, actual	\$ -3,921,941	\$ -1,450,906
17. Change in uncollected customer payments from Federal sources (+/-)	266,938	201,773
18. Obligated balance, net, end of period		
A. Unpaid obligations	60,933,360	53,989,101
B. Less: Uncollected customer payments (+/-) from Federal sources (-)	-2,366,785	-2,633,723
C. Total, unpaid obligated balance, net, end of period	58,566,575	51,355,378
<b>NET OUTLAYS</b>		
<b>19. Net Outlays:</b>		
A. Gross outlays	\$ 146,107,640	\$ 142,001,769
B. Less: Offsetting collections	-10,614,293	-9,160,512
C. Less: Distributed Offsetting receipts	-140,980	-185,423
<b>20. Total Net Outlays</b>	<b>\$ 135,352,367</b>	<b>\$ 132,655,834</b>

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



# General Fund

Fiscal Year 2007

## Notes to the Principal Statements

Notes to the financial statements communicate information essential for fair presentation of the financial statements that is not displayed on the face of the financial statements.



## Note 1. Significant Accounting Policies

### 1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Air Force, as required by the “Chief Financial Officers Act of 1990,” expanded by the “Government Management Reform Act of 1994,” and other appropriate legislation. The financial statements have been prepared from the books and records of the Air Force in accordance with the “Department of Defense Financial Management Regulation”, Office of Management and Budget (OMB) Circular 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 DoD no longer publishes consolidating/combining financial statements. The accompanying financial statements account for all resources for which the Air Force 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 Air Force is unable to fully implement all elements of GAAP and OMB Circular A-136 due to limitations of its financial and nonfinancial management processes and systems that feed into the financial statements. The Air Force derives its reported values and information for major asset and liability categories largely from nonfinancial systems, such as inventory and logistic 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 Air Force continues to implement process and system improvements addressing these limitations.

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

The Air Force currently has nine auditor identified financial statement material weaknesses: (1) financial and nonfinancial feeder systems do not contain an adequate audit trail and other systems controls, (2) intragovernmental transactions cannot be accurately identified by the customer, which is required for eliminations when preparing consolidated financial statements, (3) operating materials and supplies may not be reported in the financial statements accurately, (4) the Air Force needs additional controls over financial reporting for general property, plant and equipment (PP&E), (5) the value of the Air Force government furnished and contractor acquired material is not accurately reported, (6) the amounts for environmental liability may not be reliable due to lack of supporting documentation, (7) the Air Force has material amounts of accounting adjustments that are not adequately supported, (8) the Statement of Net Cost is based on budgetary obligations, disbursements and collections and may not report all actual cost, and (9) the Air Force is unable to reconcile budgetary obligations to net cost in Note 21, “Reconciliation of Net Cost of Operations to Budget.” These findings are being addressed with corrective actions in the Financial Improvement Plan.

### 1.B. Mission of the Reporting Entity

The United States Air Force was created on September 18, 1947, by the National Security Act of 1947. The National Security Act Amendments of 1949 established DoD and made the Air Force a department within DoD. The overall mission of the Air Force is to deliver sovereign options for the defense of the United States of America and its global interests to fly and fight in air, space and cyberspace.

## 1.C. Appropriations and Funds

The Air Force receives its appropriations and funds as general, working capital (revolving), trust, special, and deposit funds. The Air Force 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, operations and maintenance, research and development, procurement, and military construction accounts.
- Trust funds contain receipts and expenditures of funds held in trust by the government for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute. 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 Air Force is acting as an agent or custodian for funds awaiting distribution.

The Air Force is a party to allocation transfers with other federal agencies as a transferring (parent) entity and 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 all U.S. Treasury-Managed Trust Funds, Executive Office of the President (EOP), and all other funds specifically designated by OMB.

The Air Force is a party to allocation transfers as the child for the Department of Agriculture.

The Air Force is a party to allocation transfers as the child for EOP (Foreign Military Sales – Military Assistance Program) meeting the OMB exception. However, activities for this fund are reported in the DOD financial statements, not the Air Force.

The Air Force allocates funds, as the parent, to the Department of Transportation.

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

<b>Air Force Account Number</b>	<b>Title</b>
57 * 0704	Military Family Housing (O&M and Construction), Air Force
57 * 0740	Military Family Housing (Construction), Air Force
57 * 0745	Military Family Housing (O&M), Air Force
57 * 0810	Environmental Restoration, Air Force



57 * 1007	Medicare Eligible Retiree Health Fund Contributions, Air Force
57 * 1008	Medicare Eligible Retiree Health Fund Contributions, Air Force Reserve
57 * 1009	Medicare Eligible Retiree Health Fund Contributions, Air National Guard
57 * 3010	Aircraft Procurement, Air Force
57 * 3011	Procurement of Ammunition, Air Force
57 * 3020	Missile Procurement, Air Force
57 * 3080	Other Procurement, Air Force
57 * 3300	Military Construction, Air Force
57 * 3400	Operation and Maintenance (O&M), Air Force
57 * 3500	Military Personnel, Air Force
57 * 3600	Research, Development, Testing, and Evaluation (RDT&E), AF
57 * 3700	Personnel, Air Force Reserve
57 * 3730	Military Construction, Air Force Reserve
57 * 3740	Operation and Maintenance (O&M), Air Force Reserve
57 * 3830	Military Construction, Air National Guard
57 * 3840	Operation and Maintenance (O&M), Air National Guard
57 * 3850	Personnel, Air National Guard
57 X 5095	Wildlife Conservation, etc., Military Reservations, Air Force
57 X 8418	Air Force Cadet Fund
57 X 8928	Air Force General Gift Fund
57 * 3XXX (Incl Nonentity)	Budget Clearing Accounts
57 * 6XXX (Nonentity)	Deposit Fund Accounts
57 **** (Nonentity)	Receipt Accounts

### 1.D. Basis of Accounting

For FY 2007, the Air Force's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the Air Force's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of 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 Air Force's financial and nonfinancial legacy systems were designed to record information on a budgetary basis. However, some accounts such as civilian pay, military pay and accounts payable are presented on the accrual basis of accounting on the financial statements, as required by federal accounting standards.

The DoD 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 Air Force's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, the Air Force's financial data will be derived from budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and accruals made for major items such as payroll expenses, accounts payable, and environmental liabilities.

In addition, DoD 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 DoD is working towards a cost reporting

methodology that meets the need for cost information required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, “Managerial Cost Accounting Concepts and Standards for the Federal Government.”

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

The Air Force 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 Air Force recognizes revenue as a result of costs incurred for goods or services provided to other federal agencies and the public. Full cost pricing is the Air Force’s standard policy for services provided as required by OMB Circular A-25, User Charges. The Air Force recognizes revenue when earned within the constraints of current system capabilities. In some instances, revenue is recognized when bills are issued.

The Air Force 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 in Note 21, “Reconciliation of Net Cost of Operations to Budget.” The U.S. has cost sharing agreements with other countries. Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. fleet is in a port.

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

For financial reporting purposes, the DoD policy requires the recognition of operating expenses in the period incurred. However, because the Air Force’s financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accruals are made for major items such as payroll expenses, accounts payable, environmental liabilities, and unbilled revenue. In the case of Operating Materials and Supplies (OM&S), operating expenses are generally recognized when the items are consumed. In general, the Air Force uses the consumption method of accounting for OM&S, since OM&S is defined in the SFFAS No. 3, “Accounting for Inventory and Related Property,” as materiel that has not been issued to the end user.

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

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within the DoD or between two or more federal agencies. However, the Air Force cannot accurately eliminate intragovernmental transactions by customer because the Air Force’s systems do not track at the transaction level. Generally, seller entities within the DoD provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records are adjusted to agree with the DoD 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 DoD 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 DoD 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 Policy Guide,” provide guidance for reporting and reconciling intragovernmental balances. While the Air Force is unable to fully reconcile intragovernmental transactions with all federal partners, the Air Force is able to reconcile balances pertaining to investments in federal securities, 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 to the Federal Government are not included. The Federal Government does not apportion debt and its related costs to federal agencies. The DoD's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

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

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

Each year, the Air Force 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, DoD has authority to sell defense articles and services to foreign countries and international organizations generally at no profit or loss to the U.S. Government. Payment in U.S. dollars is required in advance.

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

The Air Force'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 Air Force'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, the 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 Air Force'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 DoD, 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.

The Air Force 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: operations and maintenance, military personnel, military construction, family housing operations 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 Air Force does not separately identify currency fluctuation transactions.

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

As presented in the Balance Sheet, accounts receivable include three categories: accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. The DoD does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies 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>.

The allowance for the Air Force entity receivables is computed each quarter based on the average percent of write offs to outstanding public accounts receivable for the last five years. Interest allowance is calculated using an average percent of write offs to outstanding public accounts receivable over a five year period starting with FY 2002 data.

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

Not Applicable

### **1.M. Inventories and Related Property**

Related property includes OM&S and stockpile materiels. The majority of OM&S, with the exception of munitions not held for sale, are valued using the moving average cost method. Munitions not held for sale are valued at standard purchase price. The Air Force uses consumption method for OM&S in all cases.

The Air Force 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 Air Force 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.

### **1.N. Investments**

The Air Force 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 Air Force’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 Air Force 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.

### **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 DoD used 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 DoD replaced the BEA estimation methodology with one that is based on internal records for military equipment. The DoD 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 Air Force 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.

General PP&E assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds the DoD capitalization threshold of \$100 thousand. The DoD also requires capitalization of improvement costs over the DoD capitalization threshold of \$100 thousand for General PP&E. The DoD depreciates all General PP&E, other than land, on a straight-line basis.

General PP&E previously capitalized at amounts below \$100 thousand were written off General Fund financial statements in FY 1998.

When it is in the best interest of the government, the Air Force provides government property to contractors to complete contract work. The Air Force either owns or leases such property, or it is purchased directly by the contractor for the government based on contract terms. When the value of contractor-procured General PP&E exceeds the DoD capitalization threshold, Federal accounting standards require that it be reported on the Air Force's Balance Sheet. Currently, the Air Force only reports on the Balance Sheet the value of property that the Air Force owns or leases to the contractor. The Air Force does not report the value of equipment purchased directly by the contractor.

The DoD 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, Air Force reports only government property in the possession of contractors that is maintained in Air Force's property systems. The Air Force does not report the value of equipment purchased directly by the contractor. The DoD has issued new property accountability and reporting requirements that require Air Force to maintain, in their property systems, information on all property furnished to contractors. This action and other DoD proposed actions are structured to capture and report the information necessary for compliance with federal accounting standards.

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

The Department'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 DoD's policy is to expense and/or properly classify assets when the related goods and services are received.

### **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), Air Force records the applicable asset and liability if the value equals or exceeds the current capitalization threshold. The Air Force 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 ei-

ther the lessor’s implicit interest rate or the government’s incremental borrowing rate at the inception of the lease. The Air Force, 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 Air Force 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 DoD inflation factor. The CPI impacts increases to the leases, especially those at commercial lease sites. Equipment leases have a variety of lease terms which are not expected to be renewed upon expiration. Other operating leases are generally one-year leases.

### **1.R. Other Assets**

Other assets include those assets, such as military and civil service employee pay advances, travel advances, and certain contract financing payments that are not reported elsewhere on Air Force’s Balance Sheet.

The Air Force conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, Air Force 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 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 Acquisition 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 the Department’s 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 Air Force 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 Air Force’s risk of loss and resultant contingent liabilities arise from pending or threatened litigation or claims and assessments due to events such as aircraft and vehicle accidents; medical malpractice; property or environmental damages; and contract disputes.

Other liabilities arise as a result of anticipated disposal costs for Air Force’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. Nonen-



Environmental disposal liabilities are recognized for assets when management decides to dispose of an asset based upon the DoD's policy, which is consistent with SFAS No. 5, "Accounting for Liabilities of Federal Government." Air Force does not recognize contingent liabilities associated with nonenvironmental disposals due to immateriality.

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

The Air Force 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 that 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 that were not reimbursed.

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

The DoD 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 Air Force purchases capital assets overseas with appropriated funds; however, the host country retains title to land and improvements. Generally, treaty terms allow the Air Force 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 clean-up.

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

Not Applicable

### **1.X. Unexpended Obligations**

The Air Force obligates funds to provide goods and services for outstanding orders not yet delivered. The financial statements do not reflect this liability for payment for goods or services not yet delivered, 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 monthly 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 DoD 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 4<sup>th</sup> Quarter, FY 2007, DoD began presenting the Statement of Financing (SOF) as a note in accordance with the (OMB) Circular A-136. The SOF will no longer be considered a basic statement and is now referred to as “Reconciliation of Net Cost of Operations to Budget.”

## Note 2. Nonentity Assets

As of September 30	2007		2006	
(amounts in thousands)				
<b>1. Intragovernmental Assets</b>				
A. Fund Balance with Treasury	\$	94,844	\$	80,989
B. Accounts Receivable		2,376		2,715
C. Total Intragovernmental Assets	\$	97,220	\$	83,704
<b>2. Nonfederal Assets</b>				
A. Cash and Other Monetary Assets	\$	107,908	\$	114,779
B. Accounts Receivable		157,416		568,289
C. Other Assets		186,025		196,826
D. Total Nonfederal Assets	\$	451,349	\$	879,894
3. Total Nonentity Assets		548,569		963,598
<b>4. Total Entity Assets</b>	\$	281,086,886	\$	271,987,028
<b>5. Total Assets</b>	\$	<b>281,635,455</b>	\$	<b>272,950,626</b>

### Relevant Information for Comprehension

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

Intragovernmental Fund Balance with Treasury asset class represents amounts in Air Force’s deposit fund and two suspense fund accounts (Uniformed Services Thrift Savings Plan Suspense and Thrift Savings Plan Suspense) that are not available for Air Force use.

Intragovernmental Accounts Receivable when collected goes to the U.S. Treasury as miscellaneous receipts.

Nonfederal Cash and Other Monetary Assets represent disbursing officers’ cash and undeposited collections as reported on the Statement of Accountability (Standard Form 1219). These assets are held by the Air Force disbursing officers as agents of the U.S. Treasury.

Nonfederal Accounts Receivable, when collected, goes to the U.S. Treasury as miscellaneous receipts.

The Nonfederal Accounts Receivable amount also includes interest receivables on aged debts.



Nonfederal Other Assets consist of advances to contractors as part of the advance payment pool agreements with the Massachusetts Institute of Technology and other nonprofit institutions. These agreements are used for the financing of cost-type contracts with nonprofit educational research institutions for experimental, research and development work when several contracts or a series of contracts require financing by advance payments.

### Note 3. Fund Balance with Treasury

As of September 30	2007	2006
(amounts in thousands)		
<b>1. Fund Balances</b>		
A. Appropriated Funds	\$ 80,023,587	\$ 68,762,362
B. Revolving Funds	0	0
C. Trust Funds	6,824	3,944
D. Special Funds	1,140	872
E. Other Fund Types	\$ 94,845	80,989
F. Total Fund Balances	<u>\$ 80,126,396</u>	<u>\$ 68,848,167</u>
<b>2. Fund Balances Per Treasury Versus Agency</b>		
A. Fund Balance per Treasury	\$ 81,162,222	\$ 69,960,267
B. Fund Balance per Air Force	80,126,396	68,848,167
<b>3. Reconciling Amount</b>	<u>\$ 1,035,826</u>	<u>\$ 1,112,100</u>

### Fund Balance with Treasury

Other Fund Types include balances in deposit fund accounts for Small Escrow, State and Local Taxes, Servicemen's Group Life Insurance fund, and Uniformed Services Thrift Savings Plan (TSP).

The Air Force shows a reconciling amount of \$1.0 billion with the U.S. Treasury, which is comprised of :

- \$18.3 million in allocation transfers to Air Force from the Department of Agriculture and the Foreign Military Sales-Military Assistance Program (MAP). The U.S. Treasury reports these funds as Air Force in the Fund Balance with Treasury (FBWT), but Air Force does not include in its FBWT because the Departments of Agriculture and MAP report these balances in their financial statements.
- \$158.5 million in withdrawal of the FBWT for unavailable receipt accounts at September 30, 2007. These funds are included in FBWT per U.S. Treasury but not included in FBWT per Air Force.
- \$868.0 million in withdrawal of the FBWT in the cancelling appropriations at September 30, 2007. These funds are included in FBWT per U.S. Treasury but not included in FBWT per Air Force.
- \$9.4 million in allocation transfers from Air force to the Department of Transportation. These funds are reported in FBWT by Air Force but are not included in FBWT at U.S. Treasury, because U.S. Treasury reports these balances under Department of Transportation.

## Status of Fund Balance with Treasury

As of September 30	2007	2006
(amounts in thousands)		
<b>1. Unobligated Balance</b>		
A. Available	\$ 18,577,110	\$ 15,001,790
B. Unavailable	2,598,234	2,111,136
<b>2. Obligated Balance not yet Disbursed</b>	60,933,360	53,989,101
<b>3. Reconciling Amount</b>	385,286	380,571
<b>4. NonFBWT Budgetary Accounts</b>	-2,367,594	-2,634,431
<b>5. Total</b>	<b>\$ 80,126,396</b>	<b>\$ 68,848,167</b>

## Status of Fund Balance with Treasury

The Status of Fund Balance with Treasury (FBWT) reflects both budgetary and nonbudgetary resources.

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. The items reported consist of FBWT for suspense, deposit and receipt accounts.

NonFBWT Budgetary Accounts represent adjustments to budgetary account that do not affect FBWT. The items that comprise the amount reported as NonFBWT consist of reimbursements and other income earned receivable, investments and discounts in U.S. Treasury securities, and unfilled customer orders without advances. This category reduces the Status of FBWT.

Unobligated balances are segregated to show available and unavailable amounts in the note schedule. Certain unobligated balances may be restricted to future use and are not apportioned for current use. The unobligated balance unavailable of \$2.6 billion is not available for new obligations because the period for new obligations established by law has expired.



## Disclosures Related to Suspense/Budget Clearing Accounts

As of September 30	2005	2006	2007	(Decrease)/ Increase from FY 2006 - 2007
(amounts in thousands)				
<b>Account</b>				
F3845 – Personal Property Proceeds	\$ 0	\$ 0	\$ 0	\$ 0
F3875 – Budget Clearing Account Suspense	336,053	362,040	358,605	-3,435
F3880 – Lost or Cancelled Treasury Checks	691	553	374	-179
F3882 – Uniformed Services Thrift Savings Plan Suspense	25,523	30,802	32,842	2,040
F3885 – Interfund/IPAC Suspense	-74,564	-63,012	-68,537	-5,525
F3886 – F3886 – Thrift Savings Plan Suspense	0	0	0	0
<b>Total</b>	<b>\$ 287,703</b>	<b>\$ 330,383</b>	<b>\$ 323,284</b>	<b>\$ -7,099</b>

### Relevant Information for Comprehension

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

The F3875 suspense account 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.

## Disclosures Related to Problem Disbursements

As of September 30	2005	2006	2007	(Decrease)/ Increase from FY 2006 - 2007
(amounts in thousands)				
<b>1. Total Problem Disbursements, Absolute Value</b>				
A. Unmatched Disbursements (UMDs)	\$ 272,972	\$ 32,063	\$ 97,098	\$ 65,035
B. Negative Unliquidated Obligations (NULO)	8,209	6,291	6,201	-90
C. In-Transit Disbursements	1,027,549	1,333,019	1,013,198	-319,821
<b>2. Total</b>	<b>\$ 1,308,730</b>	<b>\$ 1,371,373</b>	<b>\$ 1,116,497</b>	<b>\$ -254,876</b>

### Relevant Information for Comprehension

The amount of Unmatched Disbursements (UMDs) over 180 days is \$0, Negative Unliquidated Obligations (NULOs) is \$0, and in-transits is \$3.2 million. The amount of UMDs over 120 days old is \$0, NULOs is \$0, and in-transits is \$5.8 million. The current value of net in-transits is \$599.2 million.

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 Disbursements represent the absolute value of disbursements and collections made by an Air Force 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 net amounts disclosed in prior years. This reporting change applies to amounts in the note schedule for both the current and comparative years.



## Note 4. Investments and Related Interest

As of September 30	2007				
	Cost	Amortization Method	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure
(amounts in thousands)					
<b>1. Intragovernmental Securities</b>					
A. Nonmarketable, Market-Based					
1. Military Retirement Fund	\$ 0		\$ 0	\$ 0	\$ 0
2. Medicare Eligible Retiree Health Care Fund	0		0	0	0
3. US Army Corps of Engineers	0		0	0	0
4. Other Funds	816		-1	815	820
5. Total Nonmarketable, Market-Based	816		-1	815	820
B. Accrued Interest	8			8	9
C. Total Intragovernmental Securities	\$ 824		\$ -1	\$ 823	\$ 829
<b>2. Other Investments</b>					
A. Total Other Investments	\$ 0		\$ 0	\$ 0	N/A

As of September 30	2006				
	Cost	Amortization Method	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure
(amounts in thousands)					
<b>3. Intragovernmental Securities</b>					
A. Nonmarketable, Market-Based					
1. Military Retirement Fund	\$ 0		\$ 0	\$ 0	\$ 0
2. Medicare Eligible Retiree Health Care Fund	0		0	0	0
3. US Army Corps of Engineers	0		0	0	0
4. Other Funds	713		1	714	712
5. Total Nonmarketable, Market-Based	713		1	714	712
B. Accrued Interest	8			8	8
C. Total Intragovernmental Securities	\$ 721		\$ 1	\$ 722	\$ 720
<b>4. Other Investments</b>					
A. Total Other Investments	\$ 0		\$ 0	\$ 0	N/A

### Relevant Information for Comprehension

The Federal Government does not set aside assets to pay future benefits and expenditures associated with earmarked funds. The cash generated from earmarked funds are deposited in the U.S. Treasury, which uses the cash for general Government purposes. U.S. Treasury securities are issued to the earmarked funds as evidence of earmark fund receipts. The U.S.

Treasury securities are an asset to the Air Force and a liability to the U.S. Treasury. Because the Air Force and the U.S. Treasury are both parts of the Federal 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. Government wide financial statements. The U.S. Treasury securities provide the Air Force with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When the Air Force 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 the Government finances all other expenditures.

### Note 5. Accounts Receivable

As of September 30	2007			2006	
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net	
(amounts in thousands)					
1. Intragovernmental Receivables	\$ 388,823	N/A	\$ 388,823	\$ 665,672	
2. Nonfederal Receivables (From the Public)	\$ 602,261	\$ -56,465	\$ 545,796	\$ 1,041,746	
3. Total Accounts Receivable	<u>\$ 991,084</u>	<u>\$ -56,465</u>	<u>\$ 934,619</u>	<u>\$ 1,707,418</u>	

### Relevant Information for Comprehension

As presented on the Consolidated Balance Sheet, accounts receivable includes reimbursement receivable and refund receivable such as out-of-service debts (\$ owed by former service members) and contractor debts. It also includes net interest receivables. Canceled accounts receivable are reported as nonentity receivables because these amounts are deposited into a U.S. Treasury miscellaneous receipt account when collected. Reconciliation between Treasury Report on Receivables (TROR) Due from the Public and the Balance Sheet was accomplished. This reconciliation is performed to ensure that the financial statements are in agreement with the receivable amount reported to the U.S. Treasury. The difference between accounts receivable on the Balance Sheet and TROR Due from the Public include the allowance for estimated uncollectible of \$56.5 million, unsupported collections in-transit in the amount of \$606.0 thousand and undistributed collections of \$236.0 thousand. Undistributed collections are prorated between public and intragovernmental receivables based on a percentage calculated from receivable amounts represented on the Balance Sheet.



## Aged Accounts Receivable

As of September 30	2007		2006	
	Intragovernmental	Nonfederal	Intragovernmental	Nonfederal
(amounts in thousands)				
CATEGORY				
<b>Nondelinquent</b>				
Current	\$ 727,855	\$ 236,748	\$ 1,085,890	\$ 193,635
Noncurrent	0	0	5,725	0
<b>Delinquent</b>				
1 to 30 days	\$ 20,902	\$ 7,130	\$ 34,155	\$ 6,010
31 to 60 days	1,216	3,483	122,543	4,677
61 to 90 days	951	6,200	28,469	6,744
91 to 180 days	170	14,036	64,611	21,217
181 days to 1 year	250	25,829	55,201	41,513
Greater than 1 year and less than or equal to 2 years	122	47,914	7,145	12,565
Greater than 2 years and less than or equal to 6 years	86	54,582	6,437	705,483
Greater than 6 years and less than or equal to 10 years	0	188,099	0	179,819
Greater than 10 years	0	22,069	0	17,702
<b>Subtotal</b>	<b>\$ 751,552</b>	<b>\$ 606,090</b>	<b>\$ 1,410,176</b>	<b>\$ 1,189,365</b>
Less Supported Undistributed Collections	-1,530	-3,829	-665	-94
Less Eliminations	-361,199	0	-743,840	0
Less Other	0	0	0	0
<b>Total</b>	<b>\$ 388,823</b>	<b>\$ 602,261</b>	<b>\$ 665,671</b>	<b>\$ 1,189,271</b>

### Relevant Information for Comprehension

During the 1<sup>st</sup> Quarter, FY 2007, intragovernmental and nonfederal receivables in all aging categories were adjusted to bring the DFAS-Dayton accounting information into compliance with DoD Financial Management Regulation policy on posting and aging of receivables. These adjustments were part of a comprehensive clean-up effort by the Air Force and DFAS.

Demand letters are sent to nonfederal debtors once the payment becomes 30 days delinquent in accordance with the procedures outlined in the Concept of Operations for Managing Accounts Receivables. The delinquencies for the Air Force consist primarily of debts that have been turned over to the Contract Debt System (CDS) and the Defense Debt Management System (DDMS) for resolution.

The \$21.0 million in Intragovernmental Delinquent Receivables (1 to 30 days old) consists primarily of internal Air Force billings and will be collected in the next 30 days.

The majority of the \$369.0 million in Nonfederal Delinquent Receivables (From the Public) consists primarily of delinquent contractor debts and interest penalties associated with those debts. The Debt Management Office is actively pursuing collection of these debts.

## Note 6. Other Assets

As of September 30	2007	2006
(amounts in thousands)		
<b>1. Intragovernmental Other Assets</b>		
A. Advances and Prepayments	\$ 423,952	\$ 454,968
B. Other Assets	0	0
C. Total Intragovernmental Other Assets	\$ 423,952	\$ 454,968
<b>2. Nonfederal Other Assets</b>		
A. Outstanding Contract Financing Payments	\$ 10,183,088	\$ 11,098,138
B. Other Assets (With the Public)	265,730	280,988
C. Total Nonfederal Other Assets	\$ 10,448,818	\$ 11,379,126
<b>3. Total Other Assets</b>	<b>\$ 10,872,770</b>	<b>\$ 11,834,094</b>

### Relevant Information for Comprehension

Nonfederal Other Assets (With the Public) is comprised primarily of advances to contractors as part of advance payment pool agreements with the Massachusetts Institute of Technology and other nonprofit institutions and travel advances. The advance payment pool agreements are used for the financing of cost type contracts with nonprofit educational or research institutions for experimental or research and development work when several contracts or a series of contracts require financing by advance payments.

Contract terms and conditions for certain types of contract financing payments convey certain rights to the Air Force 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 Air Force is not obligated to make payment to the contractor until delivery and acceptance.

The Contract Financing Payment balance of \$10.2 billion is comprised of \$9.6 billion in contract financing payments and an additional \$720.3 million in estimated future funded payments that will be paid to the contractor upon future delivery and government acceptance of a satisfactory product. (See additional discussion in Note 15, Other Liabilities).



## Note 7. Cash and Other Monetary Assets

As of September 30	2007	2006
(amounts in thousands)		
1. Cash	\$ 104,681	\$ 111,641
2. Foreign Currency	3,227	3,138
3. Other Monetary Assets	0	0
4. Total Cash, Foreign Currency, & Other Monetary Assets	\$ 107,908	\$ 114,779

### Relevant Information for Comprehension

Cash and foreign currency are nonentity assets and, as such, are considered restricted assets that are held by the Air Force but not available for use in its operations. These assets are held by the Air Force's Disbursing Officers as agents of the U.S. Treasury. The total balance of \$108.0 million is restricted.

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

Not Applicable

## Note 9. Inventory and Related Property

As of September 30	2007	2006
(amounts in thousands)		
1. Inventory, Net	\$ 0	\$ 0
2. Operating Materiel & Supplies, Net	46,335,059	48,584,335
3. Stockpile Materiel, Net	0	0
4. Total	\$ 46,335,059	\$ 48,584,335

### Inventory, Net

Not Applicable

## Operating Materiels and Supplies, Net

As of September 30	2007			2006	Valuation Method
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	
(amounts in thousands)					
<b>1. OM&amp;S Categories</b>					
A. Held for Use	\$ 35,998,482	\$ 0	\$ 35,998,482	\$ 37,448,202	SP, LAC
B. Held for Repair	10,336,577	0	10,336,577	11,136,133	SP, LAC
C. Excess, Obsolete, and Unserviceable	1,489,448	-1,489,448	0	0	NRV
<b>D. Total</b>	<b>\$ 47,824,507</b>	<b>\$ -1,489,448</b>	<b>\$ 46,335,059</b>	<b>\$ 48,584,335</b>	

### Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses    NRV = Net Realizable Value

SP = Standard Price

O = Other

AC = Actual Cost

## General Composition of OM&S

The Operating Materiels and Supplies (OM&S) include weapon systems spares, ammunition, tactical missiles, uninstalled aircraft and cruise missile engines, and uninstalled intercontinental ballistic missile motors.

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

## Restrictions on the use on OM&S

The Air Force does not maintain any OM&S restricted assets.

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

The category Held for Use includes all materiels available for issuance. OM&S classified as such is marked within each supply or inventory system with condition codes A-D.

The category Held as Excess, Obsolete, and Unserviceable includes all materiels that managers determine to be more costly to repair than to replace. Items retained for management purposes, which are beyond economic repair are coded "condemned." The net value of these items is zero and they are shown as Excess, Obsolete, and Unserviceable and assigned condition codes H, P, S, or V.

The category Held for Repair includes all economically reparable materiels and includes all other condition codes as defined by the Military Standard Transaction Reporting and Accounting Procedures Manual (DoD 4000.25-2-M).

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

Before FY 2002, the Department of Defense (DoD) categorized potentially redistributable materiel, regardless of condition, as Excess, Obsolete, and Unserviceable.



The DoD's approved methodology for determining historical cost is the Moving Average Cost (MAC). As of 3<sup>rd</sup> Quarter, FY 2007, Air Force has fully implemented MAC in three of the six systems used to report OM&S values into the accounting system. In two of the three remaining systems, the beginning inventory balances have been established, but the cost for the quantities on hand for each national stock number have not been validated. It is anticipated that a majority of the cost associated with the inventory balances in these two systems will be validated using MAC standards by December 31 2008. Validation of the beginning balance in the Combat Ammunitions System (CAS), which manages approximately 50% of all OM&S, is not scheduled to be completed until 1<sup>st</sup> Quarter, FY 2009.

Under current DoD policy, no allowance is made for serviceable, ready-to-issue, items (category Held for Use). An allowance equal to 100% of MAC or standard price, however, is made for the category Excess, Obsolete, and Unserviceable. This allowance results in a net book value of zero for items that have no intrinsic value to the Air Force. The category Held for Repair represents suspended, unserviceable (but repairable) items. Air Force will continue to report Held for Repair at MAC or standard price until Office of the Secretary of Defense guidance is provided on how to compute an allowance for repair.

### **Contractor Supported Weapon Systems (CSWS)**

Currently the OM&S values included on the financial statements for CSWS are manually reported to Defense Finance and Accounting Service (DFAS). The Air Force is currently working with these contractors to develop the information systems capability that will compute MAC, accumulate and report the Air Force's financial data to DFAS using a standard system to system interface. Once completed by 1<sup>st</sup> Quarter, FY 2009, this module and interface will be used as a prototype for implementation for most of the CSWS.

### **Operating Materials and Supplies (OM&S) Value**

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

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

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

### **Other Air Force Disclosures**

In the past, the Air Force provided only minimal OM&S accounting data that can be used to prepare the financial statements but has made considerable strides in improving the systems to provide actual transactions for completing the financial statements. However, in some cases, the data provided still consists of only beginning and ending balances for each of the asset accounts Held for Use; Excess, Obsolete, Unserviceable; and Held for Repair. Without the required additional data

(acquisitions, transfers in, amounts consumed, transfers out, trading partner data, etc.), DFAS can only report the net change between prior period ending balances and the values reported as current period ending balances.

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

## Stockpile Materials, Net

Not Applicable

## Note 10. General PP&E, Net

As of September 30	2007					2006
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
(amounts in thousands)						
<b>1. Major Asset Classes</b>						
A. Land	N/A	N/A	\$ 437,150	N/A	\$ 437,150	\$ 440,350
B. Buildings, Structures, and Facilities	S/L	20 Or 40	47,823,687	\$ -27,199,311	20,624,376	19,841,215
C. Leasehold Improvements	S/L	lease term	0	0	0	0
D. Software	S/L	2-5 or 10	621,881	-186,792	435,089	486,985
E. General Equipment	S/L	5 or 10	33,157,666	-26,038,055	7,119,611	6,468,989
F. Military Equipment	S/L	Various	243,018,606	-131,965,091	111,053,515	111,230,820
G. Assets Under Capital Lease	S/L	lease term	405,988	-296,239	109,749	125,162
H. Construction-in- Progress	N/A	N/A	3,478,390	N/A	3,478,390	3,267,590
I. Other			0	0	0	0
<b>J. Total General PP&amp;E</b>			<b>\$ 328,943,368</b>	<b>\$ -185,685,488</b>	<b>\$ 143,257,880</b>	<b>\$ 141,861,111</b>

See Note 15 for additional information on Capital Leases

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

## Relevant Information for Comprehension

### General PP&E

There are restrictions on the Air Force's ability to dispose of real property (land and buildings) located outside the continental United States.



## **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 Air Force 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 Air Force replaced the BEA estimation methodology with one that is based on departmental internal records for military equipment.

## **Other Air Force Disclosures**

In 4<sup>th</sup> Quarter, FY 2007, the Air Force used some FY 2002 ending data for Special Tools and Special Test Equipment (ST/STE) and actual data for the B2 aircraft. Air Force Equipment Management System (AFEMS) has automated the reporting process for this information. In FY 2008, ST/STE will be inventoried, costed, and loaded into AFEMS. All ST/STE should be reported by the end of FY 2009. The net book value of ST/STE for the 4<sup>th</sup> Quarter, FY 2007, remains unchanged at \$170.3 million, which is immaterial to the balance of general equipment.

The value of the Air Force’s General PP&E real property in the possession of contractors is included in the values reported above for the major asset classes of Land and Buildings, Structures, and Facilities. The value of General PP&E personal property major asset class of Software and Equipment does not include all of the General PP&E above the DoD capitalization threshold in the possession of contractors. The Air Force does not report the value of equipment purchased directly by the contractor. The Government Accountability Office, the Inspector General, DoD, and the Air Force are developing new policies and a contractor reporting process to capture General PP&E information for future reporting purposes in compliance with generally accepted accounting principles.

## **Contractor Supported Weapon Systems (CSWS)**

Air Force is working with the CSWS contractor to report all equipment in the hands of the contractors. It is anticipated that a large portion of the contractor acquired equipment will be reported through the Government On-Line Data System to the Air Force Equipment Management System (AFEMS) by December 31, 2008. AFEMS will provide accountability and reporting to the Air Force accounting system.

## **Heritage Assets**

Heritage Assets and Stewardship Land are resources that protect, restore, enhance, modernize, preserve and sustain mission capability within the Air Force through effective planning and management of natural and cultural resources to guarantee access to air, land, and waters. These assets are resources that are managed to provide multiple use activities for the public benefit. This includes actions to comply with requirements such as Federal Laws, Executive Orders, DoD policies, final governing standards and other binding agreements.

Heritage Assets consists of buildings and structures, museums, major collections, monuments and memorials, archeological sites and cemeteries, while Stewardship Land consist mainly of mission essential (donated, public domain, executive order) land. The Air Force, with minor exceptions, uses most of the buildings and structures as part of their every day activities and includes them on the balance sheet as multi-use heritage assets (capitalized and depreciated). The mission essential stewardship land is used for many different activities including general base operations, training sites, bombing ranges, recreation, and timber production.

**Buildings and Structures:** The Air Force considers 4,091 buildings and structures on Air Force bases and sites to be heritage assets. In order to be considered a heritage asset, the building and/or facility must be listed, eligible, or potentially

eligible for the National Register. These buildings and structures are maintained by each base’s civil engineering group as part of their overall responsibility.

**Museums:** The Air Force Museum System consists of 13 museums with the major museum located at Wright-Patterson Air Force Base, Ohio. It houses the main collection of historical artifacts. The museums are considered Air Force field museums or heritage centers, which also contain items of historical interest, some of which are specific to the general locality. The Air Force also has several heritage centers that are no longer considered museums.

**Major Collections:** The Air Force has three significant collections which contain the Air Force art collection and two other collections at the Air Force Academy that contain objects, memorabilia, and documents, as well as distinctive works of original art.

**Cemeteries:** The Air Force has administrative and curatorial responsibilities for 39 cemeteries on its active duty bases.

**Archeological Sites:** The Air Force has 1,425 archeological sites listed on or eligible for the National Register.

### Assets Under Capital Lease

As of September 30	2007	2006
(amounts in thousands)		
<b>1. Entity as Lessee, Assets Under Capital Lease</b>		
A. Land and Buildings	\$ 405,988	\$ 453,481
B. Equipment	0	0
C. Accumulated Amortization	-296,239	-328,319
<b>D. Total Capital Leases</b>	<b>\$ 109,749</b>	<b>\$ 125,162</b>

### Relevant Information for Comprehension

The Air Force is the lessee in nine capital leases for military family housing acquired through the Section 801 Family Housing Program. Four of the nine leases are funded on a fiscal year basis because they originated prior to FY 1992. The leases are capitalized and reported as an asset since their costs exceed the capitalization threshold of \$100.0 thousand. The net value of assets under capital lease will continue to decrease through amortization and all capital leases are scheduled to expire by 4<sup>th</sup> Quarter, FY 2015. The Air Force is not acquiring any new capital leases.



## Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2007	2006
(amounts in thousands)		
<b>1. Intragovernmental Liabilities</b>		
A. Accounts Payable	\$ 0	\$ 0
B. Debt	0	0
C. Other	512,987	971,752
D. Total Intragovernmental Liabilities	\$ 512,987	\$ 971,752
<b>2. Nonfederal Liabilities</b>		
A. Accounts Payable	\$ 234,292	\$ 185,457
B. Military Retirement and Other Federal Employment Benefits	1,132,550	1,123,322
C. Environmental Liabilities	6,093,809	5,787,360
D. Other Liabilities	\$ 2,706,792	\$ 3,494,673
E. Total Nonfederal Liabilities	10,167,443	10,590,812
<b>3. Total Liabilities Not Covered by Budgetary Resources</b>	10,680,430	11,562,564
<b>4. Total Liabilities Covered by Budgetary Resources</b>	10,169,668	10,343,006
<b>5. Total Liabilities</b>	\$ 20,850,098	\$ 21,905,570

### Information Related to Liabilities Not Covered by Budgetary Resources

Liabilities Not Covered by Budgetary Resources are liabilities for which congressional action is needed before budgetary resources can be provided.

The liabilities for Military Retirement and Other Federal Employment Benefits, Environmental Liabilities, annual leave liabilities for military and civilians, Federal Employees' Compensation Act (FECA), and unemployment compensation account for 91% of the Total Liabilities not Covered by Budgetary Resources. These liabilities will be liquidated with future appropriations because the due dates extend past the budget life cycle of appropriations currently funded and received.

The liabilities for Accounts Payable represent payables in cancelled appropriations that will be paid using available funds at the time of disbursement, subject to limitations.

Intragovernmental Liabilities Other are primarily comprised of FECA liabilities to the Department of Labor, unemployment compensation, and custodial liabilities.

Nonfederal Other Liabilities are primary comprised of capital lease liabilities, contingent liabilities, and accrued annual leave liabilities for military and civilians.

Military Retirement and Other Federal Employment Benefits not covered by budgetary resources represents the FECA actuarial in the amount of \$1.1 billion. The FECA actuarial is not due and payable during the current fiscal year. Refer to Note 17, Military Retirement and Other Federal Employment Benefits, for additional details and disclosures.

## Note 12. Accounts Payable

As of September 30	2007			2006
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
(amounts in thousands)				
1. Intragovernmental Payables	\$ 1,509,630	\$ N/A	\$ 1,509,630	\$ 1,425,771
2. Nonfederal Payables (to the Public)	3,189,303	460	3,189,763	4,269,732
<b>3. Total</b>	<b>\$ 4,698,933</b>	<b>\$ 460</b>	<b>\$ 4,699,393</b>	<b>\$ 5,695,503</b>

### Relevant Information for Comprehension

The Air Force's systems do not track intragovernmental transactions by customer at the transaction level. Therefore, internal DoD buyer-side balances are adjusted to agree with internal seller-side balances for revenue, accounts receivable, and unearned revenue. Accounts Payable were adjusted by accruing additional accounts payable and expenses.

## Note 13. Debt

Not Applicable



## Note 14. Environmental Liabilities and Disposal Liabilities

As of September 30	2007			2006
	Current Liability	Noncurrent Liability	Total	Total
(amount in thousands)				
<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)	\$ 411,589	\$ 3,381,456	\$ 3,793,045	\$ 3,638,581
2. Active Installations—Military Munitions Response Program (MMRP)	28,365	1,368,684	1,397,049	1,393,705
3. Formerly Used Defense Sites—IRP and BD/DR	0	0	0	0
4. Formerly Used Defense Sites--MMRP	0	0	0	0
B. Other Accrued Environmental Liabilities—Active Installations				
1. Environmental Corrective Action	8,900	156,475	165,375	136,910
2. Environmental Closure Requirements	4,068	83,295	87,363	99,481
3. Environmental Response at Operational Ranges	0	0	0	0
4. Other	0	0	0	0
C. Base Realignment and Closure (BRAC)				
1. Installation Restoration Program	112,590	1,330,011	1,442,601	1,204,872
2. Military Munitions Response Program	280	3,240	3,520	0
3. Environmental Corrective Action / Closure Requirements	771	9,144	9,915	81,403
4. Other	0	0	0	0
D. Environmental Disposal for Weapons Systems Programs				
1. Nuclear Powered Aircraft Carriers	0	0	0	0
2. Nuclear Powered Submarines	0	0	0	0
3. Other Nuclear Powered Ships	0	0	0	0
4. Other National Defense Weapons Systems	0	0	0	0
5. Chemical Weapons Disposal Program	0	0	0	0
6. Other	0	0	0	0
<b>2. Total Environmental Liabilities</b>	<b>\$ 566,563</b>	<b>\$ 6,332,305</b>	<b>\$ 6,898,868</b>	<b>\$ 6,554,952</b>

### Other Information Related to Environmental Liabilities

An environmental liability is a probable and measurable future outflow or expenditure of resources that exist as of the financial reporting date for environmental cleanup costs resulting from past transactions or events. For financial statement reporting purposes, the term “environmental cleanup costs” includes costs associated with environmental restoration of environmental sites funded under the Air Force portion of the Defense Environmental Restorations Program (DERP), corrective actions funded with other than DERP, Base Realignment and Closure (BRAC), and environmental costs associated with the future disposal of facilities, equipment, munitions, or closure facilities. These costs include researching and determining the existence of hazardous waste, removing, containing, and/or disposing of hazardous waste from property, or material and/or property that consist of hazardous waste at the time of shutdown or disposal of the asset. Cleanup costs may include, but are not limited to, decontamination, decommissioning, site restoration, site monitoring, closure, and post closure costs related to Air Force operations that result in hazardous waste.

## Other Categories Disclosure

Others Category Disclosure Comparative Table (amounts in thousands)		
	2007	2006
Other Accrued Environmental Costs – Other	\$ 0	\$ 0
Base Realignment and Closure – Other		
- Manpower services at BRAC installations and headquarters offices	\$ 0	\$ 214,171
Environmental Disposal for Weapons Systems Programs – Other	\$ 0	\$ 0

The Air Force has reported all environmental costs in the applicable lines below and does not have any environmental costs to report as “Other.” Therefore, this schedule shows all zeros.

The amount reported for BRAC – “Other” in FY 2006 was reclassified into the Installation Restoration Program (IRP) line in 4<sup>th</sup> Quarter, FY 2006, to better reflect the distribution of management and manpower estimates and to be consistent with DoD policy. All future management and manpower estimates will be reported in the IRP and Environmental Corrective Action/Closure Requirements lines.

### Applicable Laws and Regulations of Cleanup Requirements

The Air Force is required to clean-up contamination resulting from past waste disposal practices, leaks, spills and other past activity, which has created a public human health or environmental risk. The Air Force does this in coordination with regulatory agencies, and if applicable, with other responsible parties. The Air Force is also required to recognize closure and post closure costs for its Property Plant and Equipment (PP&E) and environmental corrective action costs for current operations. The Air Force 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 in prior years. Examples of relevant laws and regulations that are considered for discussion include:

- (a) Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)
- (b) Superfund Amendments and Reauthorization Act (SARA)
- (c) Clean Water Act
- (d) Safe Drinking Water Act
- (e) Clean Air Act
- (f) Resource Conservation and Recovery Act (RCRA)
- (g) Toxic Substances Control Act (TSCA)
- (h) Medical Waste Tracking Act
- (i) Atomic Energy Act
- (j) Nuclear Waste Policy Act
- (k) Low Level Radioactive Waste Policy Amendments Act
- (l) National Defense Authorizations Acts



The two laws with the majority of cost estimates for active environmental cleanup are CERCLA and RCRA.

### **Types of Environmental Liabilities Identified**

The Air Force has cleanup requirements for the DERP at active installations, BRAC installations, and cleanup requirements at active installations that are not covered by DERP. The Air Force is required to perform all environmental cleanup in coordination with regulatory agencies, other responsible parties, and current property owners.

The environmental cleanup of military ranges is governed by the military munitions rule in 40 CFR 266.202, Definition of Solid Waste. Environmental cleanup on ranges refers to munitions related activities. Environmental cleanup areas within a closed range are referred to as Munitions Response Areas. As studies are done to find munitions-related contamination on closed ranges, the number of cleanup projects is expected to rise. As investigations progress, the number of military munitions responses will increase to reflect specific areas of pollution. The Air Force expects the number of responses reported to increase as pollution is discovered and their identification is defined in areas less than the total boundary of the closed range.

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

The Air Force uses engineering estimates and independently validated models to estimate environmental cleanup costs. The models are either developed within the Remedial Action Cost Engineering Requirements application, or a historic comparable project, a specific bid, or an independent government cost estimate is referenced for the current project. The Air Force validates the models in accordance with DoD Instruction 5000.61 and primarily uses the models to estimate the environmental cleanup costs based on data received during a preliminary assessment and initial site investigation. The Air Force primarily uses engineering estimates after obtaining data during the remedial investigation/feasibility phase of the environmental project. Once the environmental cleanup cost estimates are complete, the Air Force complies with accounting standards to assign costs to current operating periods. Because the Accrued Environmental Restoration Liabilities is accounted for as a totally self-contained program, all direct and indirect costs of the program are captured and reported.

The accounting standard requires full cost be recognized for closure requirements. The Air Force has closure requirements or disposal liabilities at active installations. Disposal liabilities are presented as an accrued amount for the life of the landfill. The environmental closure liability for landfills is based on the proportion of the landfill used as of the reporting date. This estimate includes the cost of capping (closing) the landfill, as well as 30 years of monitoring required by federal regulations.

The Air Force 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 Air Force expenses the associated environmental cost systemically over the life of the asset. For General PP&E placed into service after September 30, 1997, the Air Force expenses the associated environmental costs systematically over the life of the asset. The Air Force expenses the full cost to cleanup contamination for Stewardship PP&E at the time the asset is placed into service. The Air Force uses the physical capacity for operating landfills method for systematic recognition. In the future, the Air Force plans to start reporting environmental liability for other facilities, such as fuel storage tanks, military and non-military equipment, and asbestos. At that time, the Air Force plans to use life expectancy in years.

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

The Air Force is not aware of any pending changes to reported values of reported Environmental Liabilities. The Air Force does understand that the liabilities can change in the future due to changes in laws and regulations, changes in agreements with regulatory agencies, and advances in technology.

### Level of Uncertainty Regarding the Accounting Estimates used to Calculate the Reported Environmental Liabilities

Environmental liabilities for the Air Force are based on accounting estimates which require certain judgments and assumptions to be made by management. The Air Force believes the estimates are reasonable based upon the information available to at the time of the calculation. Actual results may vary materially from the accounting estimates if agreements with regulatory agencies require remediation to a different degree than anticipated when the estimate was calculated. The liabilities can be further impacted if further investigation discovers contamination different than known at the time of the estimate. Air Force financial statements would be affected to the extent there are material differences between these estimates and actual costs. There are areas in which management judgment in selecting any available alternative could produce a materially different result.

Other Accrued, Non-BRAC environmental cleanup activity uses Air Force Operation and Maintenance appropriated funds. Because of the type of funding used Air Force currently does not track as environmental costs. Therefore, the costs captured for the Other Accrued, Non-BRAC environmental cleanup reflect only direct cost. It is believed that the current portion of the environmental liability is relatively small and not material. During FY 2008, the Air Force plans to develop a process for estimating the indirect cost and liability.

### Environmental Restoration for Overseas Bases

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

### Environmental Disclosures

As of September 30	2007	2006
(amounts in thousands)		
A. The unrecognized portion of the estimated total cleanup costs associated with general property, plant, and equipment.	\$ 67,280	\$ 103,690
B. Changes in total cleanup costs due to changes in laws, regulations, and/or technology.	\$ -12,662	\$ -44,891
C. Portion of the changes in estimated costs due to changes in laws and technology that is related to prior periods.	\$ -4,357	\$ 0

The unrecognized portion of the total cleanup is the estimated total cleanup cost less the amount that is recognized on the financial statements.

Changes in environmental regulations and cleanup standards resulted in a reduction of total cleanup costs.



## Note 15. Other Liabilities

As of September 30	2007			2006
	Current Liability	Noncurrent Liability	Total	Total
(amounts in thousands)				
<b>1. Intragovernmental</b>				
A. Advances from Others	\$ 0	\$ 0	\$ 882,243	\$ 622,200
B. Deposit Funds and Suspense Account Liabilities	290,441	0	290,441	299,582
C. Disbursing Officer Cash	293,933	0	293,933	311,604
D. Judgment Fund Liabilities	0	0	0	0
E. FECA Reimbursement to the Department of Labor	126,664	168,426	295,090	290,415
F. Other Total Intragovernmental Other Liabilities	271,619	0	271,619	734,458
G. Total Intragovernmental Other Liabilities	<u>\$ 1,864,900</u>	<u>\$ 168,426</u>	<u>\$ 2,033,326</u>	<u>\$ 2,258,259</u>
<b>2. Nonfederal</b>				
A. Accrued Funded Payroll and Benefits	\$ 2,066,760	\$ 0	\$ 2,066,760	\$ 965,802
B. Advances from Others	9,980	0	9,980	31,769
C. Deferred Credits	0	0	0	0
D. Deposit Funds and Suspense Accounts	95,073	0	95,073	79,865
E. Temporary Early Retirement Authority	0	0	0	130
F. Nonenvironmental Disposal Liabilities				
1. Military Equipment (Nonnuclear)	0	0	0	0
2. Excess/Obsolete	0	0	0	0
3. Conventional Munitions Disposal	0	0	0	0
G. Accrued Unfunded Annual Leave	2,250,677	0	2,250,677	2,839,835
H. Capital Lease Liability	6,897	150,828	157,725	188,119
I. Other Liabilities	1,073,845	427,436	1,501,281	2,147,588
J. Total Nonfederal Other Liabilities	<u>\$ 5,503,232</u>	<u>\$ 578,828</u>	<u>\$ 6,081,496</u>	<u>\$ 6,253,108</u>
<b>3. Total Other Liabilities</b>	<u><b>\$ 7,368,132</b></u>	<u><b>\$ 746,690</b></u>	<u><b>\$ 8,114,822</b></u>	<u><b>\$ 8,511,367</b></u>

### Relevant Information for Comprehension

The amount of Intragovernmental Other Liabilities represents Government contributions for employee benefits, unemployment compensation, education benefits, and custodial liabilities.

The amount of Nonfederal Other Liabilities represents legal contingencies, employee benefits, and contract holdbacks.

Contingent Liabilities includes \$720.3 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 payment is made. This

action protects taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as the rights of ownership. The Air Force 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 Air Force and the amount of potential future payments are estimable; the Air Force has recognized a contingent liability for estimated future payments, which are conditional pending delivery and Government acceptance.

The recorded estimated probable liability amount of \$29.4 million is included in other liabilities nonfederal for open contractor claims greater than \$100.0 thousand. At this time, these claims are not in appeal or in litigation. In addition to the contractor claims under appeal and the open contractor claims for an amount greater than \$100.0 thousand, the Air Force was party to numerous other contractor claims in amounts less than \$100.0 thousand per claim. These claims are a routine part of the contracting business and are typically resolved through mutual agreement between the contracting officer and the contractor. Because of the routine nature of these claims, no requirement exists for a consolidated tracking mechanism to record the amount of each claim, the number of open claims, or the probability of the claim being settled in favor of the claimant. The potential liability arising from these claims in aggregate would not materially affect the operations or financial condition of the Air Force. A reasonably possible liability is estimated at \$26.1 million and is not included in the reported amount but is disclosed in Note 16.

The total estimated probable liability for claims and litigation against the Air Force handled by the Civil Law and Litigation Directorate, as of September 30, 2007, was valued at \$274.1 million and is included in other liabilities nonfederal. As of September 30, 2007, the Air Force was party to 14,984 claims and litigation actions. This liability dollar amount recorded in the financial statements is an estimate based on the weighted average payout rate for the previous three years. A reasonably possible liability is estimated at \$358.9 million and is not included in the reported amount but is disclosed in Note 16. Neither past payments nor the current contingent liability estimate provides a basis for accurately projecting the results of any individual lawsuit or claim. Since monetary judgments paid to civil litigants comes from a judgment fund administered by the Treasury, it is uncertain that claims will become a liability to the Air Force. There are only two types of cases; where the Treasury will seek reimbursements from the affected agency; the Contract Dispute Act cases and select Government personnel disciplinary matters.

As of September 30, 2007, the Air Force was party to 195 contract appeals before the Armed Services Board of Contract Appeals (ASBCA). The probable amount of loss from contractor claims of \$123.9 million is included in other liabilities nonfederal. The contractor claims involve unique circumstances, which are considered by the ASBCA in formulating decisions on the cases. Such claims are funded primarily from Air Force appropriations. A reasonably possible liability is estimated at \$501.7 million and is not included in the reported amount but is disclosed in Note 16.

Contractor claims and ASBCA claims are updated annually because there are only marginal changes.

### **Estimation Methodology**

The Air Force General Counsel through legal determination assesses and categorizes all contingent legal liability cases that equal or exceed the materiality threshold set by the DoDIG. For the remaining cases falling below the dollar materiality threshold set by DoDIG, they are considered in aggregate, if the total amount of the cases equal or exceed the established materiality threshold.

The Air Force General Counsel also solicits case data through quarterly data calls from the Air Force JAC (Civil Lawsuits and Litigation Directorate) and annually from HQ AFMC/JAB (ASBCA) and HQ AFMC/PK (Open Contractor Claims and



Contract Appeals). Air Force financial management personnel use the solicited case data which includes the current reporting year and each of the prior two years to estimate the amounts of probable and reasonably possible contingent liabilities.

Air Force financial management personnel use a three year prior case analysis spreadsheet which was developed by the Air Force Audit Agency to calculate and estimate the amount of contingent liabilities (probable and reasonably possible) for reporting or disclosing in the quarterly financial statements. In cases where Air Force General Counsel discloses that a judgment has been awarded against the Air Force, these amounts will be reported on the Balance Sheet and within this note. Amounts for reasonably possible cases are disclosed in Note 16.

## Capital Lease Liability

As of September 30	2007				2006
	Land and Buildings	Equipment	Other	Total	Total
(amounts in thousands)					
<b>1. Future Payments Due</b>					
A. 2007	\$ 0	\$ 0	\$ 0	\$ 0	\$ 39,878
B. 2008	38,594	0	0	38,594	38,594
C. 2009	38,478	0	0	38,478	38,478
D. 2010	38,478	0	0	38,478	38,478
E. 2011	36,789	0	0	36,786	36,786
F. 2012	13,088	0	0	13,088	0
G. After 5 Years	26,838	0	0	26,838	43,520
H. Total Future Lease Payments Due	\$ 192,262	\$ 0	\$ 0	\$ 192,262	\$ 235,734
I. Less: Imputed Interest Executory Costs	34,537	0	0	34,537	47,615
J. Net Capital Lease Liability	<b>\$ 157,725</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 157,725</b>	<b>\$ 188,119</b>
<b>2. Capital Lease Liabilities Covered by Budgetary Resources</b>				<b>\$ 135,750</b>	<b>\$ 158,472</b>
<b>3. Capital Lease Liabilities Not Covered by Budgetary Resources</b>				<b>\$ 21,975</b>	<b>\$ 29,647</b>

## Note 16. Commitments and Contingencies

### Relevant Information for Comprehension

The Air Force is a party in various administrative proceedings and legal actions, with claims including environmental damage claims, equal opportunity matters, and contractual bid protests. We are not aware of any contingent liabilities relative to these actions.

The Air Force has accrued contingent liabilities for legal actions where the Air Force Office of the General Counsel 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 Air Force records Judgment Fund liabilities in Note 12 “Accounts Payable” and Note 15, “Other Liabilities.”

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

	(amounts in millions)
Contractual Actions:	
Contractor Claims	\$ 26.1
Appeals before Armed Services Board of Contract Appeals (ASBCA)	501.7
Claims and Litigation from Civil Law	<u>358.9</u>
<b>Total</b>	<b>\$ 886.7</b>

The amounts disclosed for litigations claims and assessments are fully supportable and agree with the Air Force’s legal representation letters and management summary schedule.

The amount of undelivered orders for open contracts citing cancelled appropriations which remain unfilled or unreconciled for which the Air Force may incur a contractual commitment for payment is \$ 939.5 million.

Contingencies that are considered both measurable and probable have been recognized as liabilities. Refer to Note 15 for further details.

The Air Force is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolution, that may or may not result in a future outflow of expenditures. Currently, Air Force does not have a systemic process by which it captures or assesses these potential contingent liabilities; therefore, the amounts reported may not fairly present the Air Force’s contingent liabilities.



## Note 17. Military Retirement and Other Federal Employment Benefits

As of September 30	2007				2006
	Present Value of Benefits	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liability	Present Value of Benefits
(amounts in thousands)					
<b>1. Pension and Health Actuarial Benefits</b>					
A. Military Retirement Pensions	\$ 0		\$ 0	\$ 0	\$ 0
B. Military Retirement Health Benefits					
C. Military Medicare-Eligible Retiree Benefits	0		0	0	0
D. Total Pension and Health Actuarial Benefits	\$ 0		\$ 0	\$ 0	\$ 0
<b>2. Other Actuarial Benefits</b>					
A. FECA	\$ 1,132,550		\$ 0	\$ 1,132,550	\$ 1,123,323
B. Voluntary Separation Incentive Programs	0		0	0	0
C. DoD Education Benefits Fund	0		0	0	0
D. Total Other Actuarial Benefits	\$ 1,132,550		\$ 0	\$ 1,132,550	\$ 1,123,323
<b>3. Other Federal Employment Benefits</b>	\$ 4,466		\$ -4,466	\$ 0	\$ 20,425
<b>4. Total Military Retirement and Other Federal Employment Benefits:</b>	<b>\$ 1,137,016</b>		<b>\$ -4,466</b>	<b>\$ 1,132,550</b>	<b>\$ 1,143,748</b>

Actuarial Cost Method Used:

Assumptions:

Market Value of investments in Market-based and Marketable Securities:

### Relevant Information for Comprehension

#### Federal Employees' Compensation Act (FECA)

The liability is determined using a method that utilizes historical benefit payment patterns to predict the ultimate payments. The projected annual benefit payments are then discounted to the present value using the Office of Management and Budget's economic assumptions for 10-year U.S. Treasury notes and bonds.

Interest rate assumptions utilized for discounting were as follows:

#### 2006

5.170% in Year 1

5.313% in Year 2

And thereafter

To adjust 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) 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 CBYs were as follows:

	2006	2007	2008	2009	2010 +
<b>COLA</b>	3.50%	3.13%	2.40%	2.40%	2.43%
<b>CPIM</b>	4.00%	4.01%	4.01%	4.01%	4.09%

The model’s resulting projections were analyzed to insure that the estimates were reliable. The analysis was based on four tests: (1) a sensitivity 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 loses per case (a measure of case-severity) in CBY 2006 to the average pattern observed during the most current three charge back years, and (4) a comparison of the estimated liability per case in the 2006 projection to the average pattern for the projections of the most recent three years.

The Air Force’s actuarial liability for workers’ compensation benefits is developed and provided by the Department of Labor at the end of each fiscal year. There is no change on a quarterly basis. A comparison of 4<sup>th</sup> Quarter, FY 2007, and 4<sup>th</sup> Quarter, FY 2006, disclosed a minor change. Programs for which actuarial benefits are computed include FECA, the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but unreported claims.

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

Intragovernmental Costs and Exchange Revenue As of September 30	2007	2006
(amounts in thousands)		
1. Intragovernmental Costs	\$ 30,577,467	\$ 30,656,499
2. Public Costs	111,884,904	111,722,498
<b>3. Total Costs</b>	<b>\$ 142,462,371</b>	<b>\$ 142,378,997</b>
4. Intragovernmental Earned Revenue	\$ -4,571,324	\$ -4,493,654
5. Public Earned Revenue	-1,144,216	-827,193
<b>6. Total Earned Revenue</b>	<b>\$ -5,715,540</b>	<b>\$ -5,320,847</b>
<b>7. Net Cost of Operations</b>	<b>\$ 136,746,831</b>	<b>\$ 137,058,150</b>

#### Relevant Information for Comprehension

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.

The Air Force’s systems do not track intragovernmental transactions by customer at the transaction level. Therefore, internal DoD buyer-side balances are adjusted to agree with internal seller-side balances for revenue. Accounts Payable were adjusted by accruing additional accounts payable and expenses.

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 by 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.

The amounts presented in this statement are based on obligations and disbursements and, thus, may not report actual accrued costs in all cases and may not meet accounting standards. As such, the information presented 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 Air Force'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 Air Force has identified \$2.0 million for the fiscal year.

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

As of September 30	2007		2006	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
(amounts in thousands)				
<b>1. Prior Period Adjustments Increases (Decreases) to Net Position Beginning Balance</b>				
A. Changes in Accounting Standards	\$ 0	\$ 0	\$ 0	\$ 0
B. Errors and Omissions in Prior Year Accounting Reports	0	0	19,309,311	0
<b>C. Total Prior Period Adjustments</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 19,309,311</b>	<b>\$ 0</b>
<b>2. Imputed Financing</b>				
A. Civilian CSRS/FERS Retirement	\$ 212,145	\$ 0	\$ 230,498	\$ 0
B. Civilian Health	479,398	0	454,584	0
C. Civilian Life Insurance	1,520	0	1,481	0
D. Judgment Fund	31,608	0	12,252	0
E. IntraEntity	0	0	0	0
<b>F. Total Imputed Financing</b>	<b>\$ 724,671</b>	<b>\$ 0</b>	<b>\$ 698,815</b>	<b>\$ 0</b>

### Relevant Information for Comprehension

The Appropriation Received line item on the Statement of Changes in Net Position (SCNP) differs from that reported on the Statement of Budgetary Resources because Appropriations Received on the SCNP do not include appropriated dedicated and earmarked receipts. Dedicated and earmarked receipts are accounted for as either nonexchange revenue or donations and forfeitures of cash and cash equivalent. This difference totals \$2.8 million.

The eliminations column on the SCNP will reflect zero dollars. Statement of Federal Financial Accounting Standards Number 27, "Identifying and Reporting Earmarked Funds," effective for reporting years after

FY 2005, required that DoD modify the SCNP. The Federal Accounting Standards Advisory Board determined that re-statement of prior comparative balances would not be allowed. To meet the requirement, additional columns were added to separately display gross amounts for earmarked funds, and all other (non earmarked) funds. In the SCNP, all offsetting

balances (i.e. transfers-in and transfers-out, revenues and expenses) for intraDoD activity between earmarked and other (nonearmarked) 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.

The amounts remitted 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 U.S. Government's cost to provide these benefits. The financial statements recognized an imputed cost as the difference between the Government's cost of providing these benefits to the employees and contributions made by and for them. OPM provides the cost factors to DFAS for computation of imputed financing cost. DFAS provides the costs to the Office of the Under Secretary of Defense (Personnel and Readiness) (OUSD [P&R]) for validation. After validation, OUSD (P&R) provides the imputed costs to the reporting components for inclusion in their financial statements.

For the Judgment Fund, the Air Force recognizes liabilities and expenses when unfavorable litigation outcomes are probable and the amounts can be estimated. The U.S. Treasury provides the dollar amount of the imputed financing. The U.S. Treasury based the imputed financing on the amount the judgment fund is expected to pay for settlements.

Other Financing Sources, Other consists of other gains and losses to adjust intragovernmental transfers in.

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.



## Note 20. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2007	2006
(amounts in thousands)		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	\$ 64,119,346	\$ 56,974,233
2. Available Borrowing and Contract Authority at the End of the Period	\$ 0	\$ 0

### Apportionment Categories

Funds are apportioned by three categories: (1) category A is apportioned quarterly, (2) category B is apportioned by activity or project, and (3) exempt are funds not subject to apportionment. The amount of direct obligations incurred and apportioned under category A is \$83.0 billion, category B is \$63.6 billion, and exempt is \$1.9 million. For reimbursable obligations incurred and apportioned, category A is \$6.5 billion, category B is \$4.0 billion, and exempt is \$13.9 million.

### Relevant Information for Comprehension

The Statement of Budgetary Resources (SBR) includes intraentity transactions because the financial statements are presented as combined and combining.

Permanent indefinite appropriations are as follows (reference Note 23 for additional information):

- Department of the Air Force General Gift Fund [10 USC 2601(b)]
- Wildlife Conservation Fund [16 USC 670(a)]

### Appropriations Received

The Appropriation Received line item on the Statement of Changes in Net Position differs from that reported on the SBR because Appropriations Received on the Statement of Changes in Net Position do not include dedicated appropriations and earmarked receipts. Dedicated and earmarked receipts are accounted for as either nonexchange revenue or donations and forfeitures of cash and cash equivalent. This difference totals \$2.8 million.

Air Force has no material differences between amounts reported on the SBR and the SF133, Report on Budget Execution.

## Note 21. Reconciliation of Net Cost of Operations to Budget

As of September 30 (amounts in thousands)	2007	2006
<b>Resources Used to Finance Activities:</b>		
<b>Budgetary Resources Obligated:</b>		
1. Obligations incurred	\$ 156,973,842	\$ 145,600,995
2. Less: Spending authority from offsetting collections and recoveries (-)	-14,269,297	-10,409,647
3. Obligations net of offsetting collections and recoveries	\$ 142,704,545	\$ 135,191,348
4. Less: Offsetting receipts (-)	-140,980	-185,423
5. Net obligations	\$ 142,563,565	\$ 135,005,925
<b>Other Resources:</b>		
6. Donations and forfeitures of property	0	0
7. Transfers in/out without reimbursement (+/-)	261,389	46,239
8. Imputed financing from costs absorbed by others	724,671	698,815
9. Other (+/-)	-1,265,895	3,690,029
10. Net other resources used to finance activities	\$ -279,835	\$ 4,435,083
<b>11. Total resources used to finance activities</b>	<b>\$ 142,283,730</b>	<b>\$ 139,441,008</b>
<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:		
A. Undelivered Orders (-)	\$ -7,144,892	\$ -2,386,909
B. Unfilled Customer Orders	627,428	-197,170
13. Resources that fund expenses recognized in prior Periods (-)	-801,933	-898,944
14. Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	140,978	185,423
15. Resources that finance the acquisition of assets (-)	-15,504,535	-17,411,172
16. Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations:		
A. Less: Trust or Special Fund Receipts Related to exchange in the Entity's Budget (-)	0	0
B. Other (+/-)	1,004,509	-3,736,270
<b>17. Total resources used to finance items not part of the Net Cost of Operations</b>	<b>\$ -21,678,445</b>	<b>\$ -24,445,042</b>
<b>18. Total resources used to finance the Net Cost of Operations</b>	<b>\$ 120,605,285</b>	<b>\$ 114,995,966</b>
<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	\$ 3,809	\$ 491,847
20. Increase in environmental and disposal liability	343,915	0
21. Upward/Downward reestimates of credit subsidy expense (+/-)	0	0
22. Increase in exchange revenue receivable from the public (-)	0	0
23. Other (+/-)	84,400	610,486
24. Total components of Net Cost of Operations that will Require or Generate Resources in future periods	\$ 432,124	\$ 1,102,333
<b>Components not Requiring or Generating Resources:</b>		
25. Depreciation and amortization	\$ 11,977,009	\$ 16,091,380
26. Revaluation of assets or liabilities (+/-)	1,429,657	569,343
27. Other (+/-)		
A. Trust Fund Exchange Revenue	0	0
B. Cost of Goods Sold	0	0
C. Operating Material and Supplies Used	25,927,617	13,272,303
D. Other	-23,624,862	-8,973,175
28. Total Components of Net Cost of Operations that will not Require or Generate Resources	\$ 15,709,421	\$ 20,959,851
<b>29. Total Components of Net Cost of Operations that will not Require or Generate Resources in the current period</b>	<b>\$ 16,141,545</b>	<b>\$ 22,062,184</b>
<b>30. Net Cost Operations</b>	<b>\$ 136,746,830</b>	<b>\$ 137,058,150</b>



## Relevant Information for Comprehension

Beginning 4<sup>th</sup> Quarter, FY 2007, the Air Force began presenting the Statement of Financing (SOF) as a note in accordance with the Office of Management and Budget Circular A-136. The SOF will no longer be considered a basic statement and is now referred to as “Reconciliation of Net Cost of Operations to Budget.”

Because of the Air Force’s financial system limitations, budgetary data is not in agreement with proprietary expenses and assets capitalized. Differences have not existed in the past so the difference between the budgetary and proprietary data is being researched to determine the cause. The note schedule was adjusted by \$7.8 million to bring it into balance with the Statement of Net Cost. The adjustment was to the Other Components not Requiring or Generating Resources category.

The following note schedule 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 consists of other gains and losses to adjust intragovernmental transfers in.

Other resources or adjustments to net obligated resources that do not affect the Net Cost of Operations, Other consists of net transfers in and transfers out without reimbursement and other gains and losses to adjust intragovernmental transfers in.

Components requiring or generating resources in future periods are costs not funded in the period the costs are incurred. The expense and the corresponding liability are recognized in the current period but the budgetary resources will not be provided until a subsequent period. The amount of liabilities not covered by budgetary resources for the 4<sup>th</sup> Quarter, FY 2007, is \$10.2 billion. In general, the changes in liabilities not covered by budgetary resources as shown on the Balance Sheet are reflected on the Reconciliation of Net Cost of Operations to Budget. Differences are a result of custodial liabilities, unfunded capital lease liabilities, and environmental liabilities covered by unobligated budgetary resources.

Liabilities not covered by budgetary resources on the Balance Sheet and the amount reported as components requiring or generating resources in future periods on the Reconciliation of Net Cost of Operations to Budget differs by \$512.4 million. This difference consists of Custodial Lease Liabilities of \$467.2 million which are offset by a nonentity asset account, not an expense; unfunded environmental liabilities of \$37.5 million which are offset by the unfunded expenses, previously estimated and recorded as unfunded; and \$7.7 million in unfunded capital leases which are offset by a funded expense account.

## Note 22. Disclosures Related to Incidental Custodial Collections

The Air Force collected \$68.1 million of incidental custodial revenues generated from collection of accounts receivable in cancelled accounts. The Air Force distributed \$68.1 million to the U.S. Treasury.

## Note 23. Earmarked Funds

BALANCE SHEET As of September 30	Military Retirement Fund	Medicare Eligible Retiree Health Care Fund	Other Earmarked Funds	Eliminations	Total
(amounts in thousands)					
<b>ASSETS</b>					
Fund balance with Treasury	\$ 0	\$ 0	\$ 7,964	\$ 0	\$ 7,964
Investments	0	0	823	0	823
Accounts and Interest Receivable	0	0	2	0	2
Other Assets	0	0	5	0	5
<b>Total Assets</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 8,794</b>	<b>\$ 0</b>	<b>\$ 8,794</b>
<b>LIABILITIES AND NET POSITION</b> As of September 30					
Military Retirement Benefits and Other Federal Employment Benefits	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Other Liabilities	0	0	4,246	-1,930	2,316
<b>Total Liabilities</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 4,246</b>	<b>\$ -1,930</b>	<b>\$ 2,316</b>
Unexpended Appropriations	0	0	0	0	0
Cumulative Results of Operations	0	0	4,548	0	4,548
<b>Total Liabilities and Net Position</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 8,794</b>	<b>\$ -1,930</b>	<b>\$ 6,864</b>
<b>STATEMENT OF NET COST</b> As of September 30					
Program Costs	\$ 0	\$ 0	\$ 16,632	\$ 0	\$ 16,632
Less Earned Revenue	0	0	-13,867	0	-13,867
<b>Net Program Costs</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 2,765</b>	<b>\$ 0</b>	<b>\$ 2,765</b>
Less Earned Revenues Not Attributable to Programs	0	0	0	0	0
<b>Net Cost of Operations</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 2,765</b>	<b>\$ 0</b>	<b>\$ 2,765</b>
<b>STATEMENT OF CHANGES IN NET POSITION</b> As of September 30					
Net Position Beginning of the Period	\$ 0	\$ 0	\$ 4,540	\$ 0	\$ 4,540
Net Cost of Operations	0	0	2,765	0	2,765
Budgetary Financing Sources	0	0	2,773	0	2,773
Other Financing Sources	0	0	0	0	0
<b>Change in Net Position</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>
<b>Net Position End of Period</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 4,548</b>	<b>\$ 0</b>	<b>\$ 4,548</b>



## **Earmarked Funds**

### **Department of the Air Force General Gift Fund [10 USC 2601 (b)]**

The Department of the Air Force General Gift Fund accepts, holds, and administers any gift, device, or bequest of real or personal property, made on the condition that it is used for the benefit (or in connection with the establishment, maintenance, or operation) of a school, hospital, library, museum, or cemetery under the Air Force's jurisdiction. The fund is available to such institutions or organizations – subject to the terms of the gift, device, or bequest.

Conditional gifts are invested in U.S. Treasury securities, and any interest earned on these securities is added back into the fund.

### **Wildlife Conservation Fund [16 USC 670 (a)]**

The Wildlife Conservation Fund provides for (1) the conservation and rehabilitation of natural resources on military installations, (2) the sustainable multipurpose use of the resources which include hunting, fishing, trapping, and nonconsumptive uses, and (3) the public access to military installations to facilitate its use – subject to safety requirements and military security. The fund is available to carry out these programs and other such expenses that may be necessary for the purpose of the cited statute.

Consisting of both appropriated and nonappropriated funding, this fund gives installation commanders the authority to collect fees from the sale of hunting and fishing permits.

### **Air Force Cadet Fund [37 USC 725 (s)]**

The Air Force Cadet Fund is maintained for the benefit of Air Force Academy cadets. Disbursements are made for the personal services of cadets such as laundry, arts, and athletics while collections are received from the same cadets at least equal to any disbursements made.

The Air Force Cadet Fund is classified as a special fund, the Air Force General Gift Fund and Wildlife Conservation Fund are trust funds. All three funds utilize receipt and expenditure accounts in accounting for and reporting the funds.

## **Relevant Information for Comprehension**

The Total Earmarked Funds column is shown as consolidated. All intraDoD activity between earmarked funds and nonearmarked funds has been eliminated from this column, which causes assets to not equal liabilities and net position.

## Note 24. Other Disclosures

As of September 30	2007 Asset Category			
	Land and Buildings	Equipment	Other	Total

(amounts in thousands)

### 1. ENTITY AS LESSEE-Operating Leases

Future Payments Due

Fiscal Year

2008	\$	54,367	\$	0	\$	113,202	\$	167,569
2009		55,125		0		117,730		172,855
2010		56,283		0		122,440		178,723
2011		57,465		0		127,337		184,802
2012		58,671		0		132,431		191,102
After 5 Years		59,903		0		137,728		197,631
<b>Total Future Lease Payments Due</b>	<b>\$</b>	<b>341,814</b>	<b>\$</b>	<b>0</b>	<b>\$</b>	<b>750,868</b>	<b>\$</b>	<b>1,092,682</b>

### Relevant Information for Comprehension

Leases in the land and buildings category include costs for operating leased housing facilities for the active Air Force in the U.S. and overseas. Section 801 Family Housing Program leases are not included in this category.

The Air Force does not have any leases in the equipment category.

Other leases consist of Air Force vehicle leases from the General Services Administration and commercial lessors located in Europe, Southwest Asia, and the U.S.

### Note 25. Restatements

Not Applicable





# General Fund

Fiscal Year 2007

Required Supplementary  
Stewardship Information



## STEWARDSHIP INVESTMENTS

Stewardship investments are substantial investments made by DoD for the long-term benefit of the nation and public, but are not physical assets owned by DoD. Stewardship investments include expenses incurred for federally financed but not federally owned physical property (Nonfederal Physical Property) and federally financed research and development (Research and Development).

## NONFEDERAL PHYSICAL PROPERTY

Nonfederal Physical Property investments are expenses included in calculating net cost incurred by the reporting entity for the purchase, construction or major renovation of physical property owned by state and local governments. The expenses include the costs identified for major additions, alterations and replacements, purchases of major equipment, and purchases or improvements of other nonfederal assets. In addition, Nonfederal Physical Property Investments include federally-owned physical property transferred to state and local governments.

**NONFEDERAL PHYSICAL PROPERTY**  
Yearly Investment in State and Local Governments  
For the Current and Four Preceding Fiscal Years  
(amounts in millions)

Categories	FY 2007	FY 2006	FY 2005	FY 2004	FY 2003
1. Transferred Assets:	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
National Defense Mission Related					
2. Funded Assets:	\$ 2.80	\$ 8.50	\$ 8.30	\$ 18.30	\$ 11.31
National Defense Mission Related					
<b>Totals</b>	<b>\$ 2.80</b>	<b>\$ 8.50</b>	<b>\$ 8.30</b>	<b>\$ 18.30</b>	<b>\$ 11.31</b>

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

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

## RESEARCH AND DEVELOPMENT

Investments in research and development are incurred in the search for new or refined knowledge and ideas and for the application or use of such knowledge and ideas for the development of new or improved products and processes with the expectation of maintaining or increasing national economic productive capacity or yielding other future benefits.

**INVESTMENTS IN RESEARCH AND DEVELOPMENT**  
 Yearly Investment in Research and Development  
 For the Current and Four Preceding Fiscal Years  
 (amounts in millions)

Categories	FY 2007	FY 2006	FY 2005	FY 2004	FY 2003
1. Basic Research	\$ 383	\$ 334	\$ 287	\$ 209	\$ 220
2. Applied Research	1,032	939	805	805	735
3. Development					
Advanced Technology Development	937	901	966	681	545
Advanced Component Development and Prototypes	2,310	1,985	1,897	1,426	4,385
System Development and Demonstration	4,094	4,172	4,179	4,390	4,341
Research, Development, Test and Evaluation					
Management Support	1,286	1,271	824	890	880
Operational Systems Development	11,481	9,622	10,083	10,361	7,571
<b>4. Totals</b>	<b>\$ 21,523</b>	<b>\$ 19,224</b>	<b>\$ 19,041</b>	<b>\$ 18,762</b>	<b>\$ 18,677</b>

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

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

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

1. Advanced Technology Development is the systematic use of the knowledge or understanding gained from research directed toward proof of technological feasibility and assessment of operational and producibility activities rather than the development of hardware for service use. Employs demonstration activities intended to prove or test a technology or method.
2. Advanced Component Development and Prototypes evaluates integrated technologies in as realistic an operating environment as possible to assess the performance or cost reduction potential of advanced technology. Programs in this phase are generally system specific. Major outputs of Advanced Component Development and Prototypes are hardware and software components, or complete weapon systems, ready for operational and developmental testing and field use.
3. System Development and Demonstration concludes the program or project and prepares it for production. It consists primarily of preproduction efforts, such as logistics and repair studies. Major outputs are weapon systems finalized for complete operational and developmental testing.



4. RDT&E Management Support is support for installations and operations for general research and development use. This category includes costs associated with test ranges, military construction maintenance support for laboratories, operations and maintenance of test aircraft and ships, and studies and analysis in support of the R&D program.
5. Operational Systems Development is concerned with development projects in support of programs or upgrades still in engineering and manufacturing development, which have received approval for production, for which production funds have been budgeted in subsequent fiscal years.

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

**Basic Research** - In an effort to reduce atmospheric interference in free space laser communications, a team of Air Force scientists demonstrated new ways to deal with fading effects that occur when light interferes with itself as it propagates through atmospheric turbulence. Researchers also developed a wave optics simulation that is the first to accurately model a “partially coherent beam” to reduce signal fading due to atmospheric effects (cloud or fog).

The Air Force, in partnership with the U.S. Department of Energy and the National Science Foundation, is researching heat flow related to the field of molecular electronics. Long-chain molecules attached to tiny electrodes are used to transport and switch electrons. This effort led to development of an ultrafast thermal measurement technique critical for the stability and performance of heat sensitive micro-nano applications, such as lasers and optoelectronic devices.

**Applied Research** - Air Force scientists discovered a suitable method for applying a polymer nanocomposite solution that will serve as an electromagnetic interference (EMI) shielding material for use in protecting ground-based structures, aircraft, spacecraft, and satellites from internal and external EMI effects. The use of polymer nanocomposites as an EMI shielding material vice the current aluminum systems will result in reduced weight and eliminate corrosion resulting from the hardware necessary to keep the aluminum in place. The new method can be quickly and easily adapted as a retrofit to systems that are currently unshielded.

The Air Force is developing state-of-the-art weaponry that users can launch into the vicinity of mobile targets to autonomously find and defeat them. This capability provides increased survivability, multiple kills per pass, and minimal pilot workload. Since there is an inherent delay between observing a target and subsequently launching a weapon, users require the capability to rapidly search a large area. They also need a weapon that can operate day or night and in adverse weather. Under the Wide-Area Search Synthetic Aperture Radar program, the Air Force is partnering with industry to use Synthetic Aperture Radar (SAR) weapons technology to address the need to perform wide-area searches for mobile and relocatable targets in adverse weather. The research team transformed a SAR device into a multimode radar seeker, combining SAR technology with a ground moving-target indicator and high-range-resolution radar signal processing. Users will employ these modes to perform autonomous target classification to increase probability of kill.

The Air Force and the Federal Aviation Administration are working together to improve aircrew safety in situations where lasers are carelessly or maliciously pointed at aircraft. A team of optics, human factors, and computer specialists developed a one-of-a-kind laser positioning system integrated with a Boeing 737 flight simulator that realistically mimics a laser flashed at an aircraft cockpit from the ground. A handheld laser pointer directed at an approaching aircraft from two miles away can cause windshield glare, after images, and flash blindness that temporarily impairs vision and leaves a pilot unable to see an airport’s runway and surrounding landscape. The 4-axes-of-motion system uses fiber-optic cables to transport a laser beam from its source to the simulator. Researchers will monitor the reactions of Air Force pilots to laser illumination during simulated flights and use this data to generate safety procedures and prepare for further in-flight testing.

**Advanced Technology Development** - The Air Force developed new work-centered, interface-distributed environment software that provides a timeline visualization capability that reflects near-real-time updates to mission data and depicts a given problem in the context of related elements. The visual fusion of relevant information in the display assists operators in rapidly understanding, not only the meaning of an alert, but the factors affecting mission viability and possible solutions. Also of significance is the tool's capacity to perform "what-if" simulations. These hypothetical scenarios facilitate ongoing situational awareness by allowing operators to examine the repercussions of any changes made to the mission itinerary. This unique capability enables a prompt reaction to mission problems – a response based on actionable information and executed in a timely manner. The new capability has been deployed within the Air Mobility Division of the Al-Udeid Air Base Combined Air Operations Center in Qatar, where it is used to attain "fleet-at-a-glance" situational awareness of in-theater airlift.

As part of efforts to reduce the U.S. military's reliance on foreign energy sources, the Air Force completed certification of an alternative jet fuel on the B-52H Stratofortress bomber on August 8, 2007 at Edwards AFB, California. The signing ceremony certified that the blended Fischer-Tropsch (FT) and JP-8 fuel is safe for operational use in all B-52H aircraft and marked the formal conclusion of testing. This FT experiment is part of the Pentagon's Assured Fuel Initiative that seeks to convert coal, of which the United States has abundant reserves, into liquid fuel. The fuel is derived from refining natural gas under the FT process, which is named after its German inventors of the 1920's. The Air Force plans to test and certify every airframe to fly on a domestically produced synthetic fuel blend by early 2011.

The Air Force developed improved turbine engine life-management tools that integrate state-of-the-art material analysis, enhanced non-destructive evaluation, and data management as a comprehensive life management system. Component cost avoidance is estimated to exceed \$300 million for the F100/F110 engine series alone.

The Air Force developed a custom-molded, noise-attenuating earplug that enables seamless voice communications to and from radios, while electronically passing all outside environmental sounds to the operator at safe levels. The Joint Unmanned Combat Air Systems (J-UCAS) program was terminated in December 2005. The two J-UCAS X-45A aircraft flew a total of 64 flights and performed limited demonstrations of precision weapon drops, multi-ship coordinated flight, and collaborative targeting technologies, illustrating the potential for future unmanned combat air systems development programs. The Air Force continued to advocate the AFRL Automated Air Refueling (AAR) program, which continues to make historic progress. The AAR program consists of a combination of simulation and flight tests in order to develop the appropriate requirements and system design for UAV refueling, which may also be applied to manned refueling. In the flight test, the AAR program uses the Calspan Learjet (UAV Surrogate) and the 107th ANG KC-135 for flight test. In August 2006, during the Station-Keeping Flight Test, the AAR program demonstrated "hands-off" formation flight for over 85 minutes in the contact position and more than 229 minutes in all refueling positions. In August 2007, during the Positions and Pathways Flight Test, the AAR program successfully demonstrated maneuvering from the observation position (off the wing of the tanker) to pre-contact position, to the contact position, and then back.

**Demonstration and Validation (Advanced Component Development and Prototypes)** - The Air Force's Advanced Component Development and Prototypes programs are comprised of system specific advanced technology integration efforts accomplished in an operational environment to help expedite transition from the effort. In FY 2004, the Air Force successfully demonstrated Fighter Aircraft Command and Control Enhancement (FACE). FACE provides an improved, beyond-line-of-sight (BLOS) command and control link with fighter aircraft by integrating Iridium telephone communications equipment with existing aircraft communications equipment. BLOS capability has traditionally been provided by low-density, high-demand airborne platforms acting as communications relays. FACE provides relief for these overworked assets, while allowing combatant commanders to maintain positive control of the battle space. FACE, which has been approved for deployment to Afghanistan through the Air Force's Rapid Response Process, has the potential for extensive use in virtually any area of responsibility, including Homeland Defense.



In FY 2005, the Air Force restructured and refocused the Space Radar (SR) program (formerly Space Based Radar) to address congressional concerns with technical risk, affordability, and DoD-Intelligence Community (IC) integration. In January 2005, the Secretary of Defense and the Director of Central Intelligence signed a joint memo designating the SR program as the single space radar capability for the nation. In May 2007, the Deputy Secretary of Defense and the Principle Deputy Director of National Intelligence signed the Joint Radar Enterprise Memorandum, agreeing to a joint funding arrangement, acquisition strategy, and management structure. The details of this arrangement are being captured in the Joint Radar Enterprise Management Plan. The SR Initial Capabilities Document (ICD) was approved by the IC Mission Requirements Board (MRB) in December 2005 and the DoD Joint Requirements Oversight Council (JROC) in January 2006. The Capability Development Document is being prepared in parallel with the SR system concept of operations (CONOPS), and both are on track for MRB and JROC approval in 1<sup>st</sup> Quarter, FY 2009. In addition, the IC and OSD Cost Analysis Improvement Groups (CAIG) are developing a comprehensive joint Independent Cost Estimate (ICE), with an expected completion date of November 2007. The SR program implemented a demonstration framework approach to system development. This approach will further technology maturity risk reduction and CONOPS experimentation through a mix of space, air, and land-based demonstration activities that will maximize existing assets. The SR program continues to make significant advancement towards the System Requirements Review milestone scheduled for 1<sup>st</sup> Quarter, FY 2008. The SR program will provide day/night, all-weather global surface moving target indications (MTI), SAR, and high-resolution terrain information (HRTI) capabilities from a space-based platform. Initial launch capability is planned for 4<sup>th</sup> Quarter, FY 2016.

**System Development and Demonstration** - The Air Force's System Development & Demonstration (SDD) efforts are development projects which have not received approval for full-production. In FY 2006, the F-22 Raptor program closed out Engineering and Manufacturing Development (EMD) and is now in Full Rate Production. The Air Combat Command at Langley AFB, VA, achieved Initial Operational Capability (IOC) in December 2005. In closing out EMD in June 2006, the F-22 program completed the full-scale airframe structural fatigue testing and analysis, completed support and test of the flight test engines, and completed integration of the Operational Flight Program (OFP) software in the Avionics Integration Lab for future software development and support efforts. The successful conclusion of EMD laid the foundation for future F-22 Raptor enhancements under the current incremental modernization strategy.

The F-35 Joint Strike Fighter (JSF) program is developing a family of strike fighter aircraft for the Air Force, Navy, Marine Corps and our allies, with maximum commonality among the variants to minimize life cycle costs. The Air Force Conventional Takeoff and Landing (CTOL) variant will be a multi-role, primary air-to-ground aircraft to replace the F-16 and A-10 and complement the F-22. While the F-22 will establish air dominance, the F-35 with its combination of stealth, large internal payloads and multi-spectral avionics will provide persistent stealth and precision engagement to the future battlespace. The F-35 is in the 6<sup>th</sup> year of a 12-year SDD effort. Significant program accomplishments in FY 2007 include:

- First flight of CTOL AA-1 on December 15, 2006
- Completed Critical Design Review (CDR) for Carrier Variant (CV) in June 2007
- Awarded contract for Low Rate Initial Production (LRIP) Lot 1 (2 CTOL aircraft) in July 2007
- Fourteen test aircraft are currently in assembly (5 CTOLs, 5 STOVLs, and 4 CVs)

The Transformational Satellite Communications (TSAT) system will provide the essential capabilities required to enable the DoD's vision for 21<sup>st</sup> century military operations. TSAT, which consists of a five-satellite geosynchronous satellite constellation, network operations centers, and associated ground architecture, will establish global internet-like connectivity that is essential for U.S. and allied personnel to communicate as a joint networked force. It will also extend assured, protected communications connectivity to mobile forces in theater and vastly increase the overall capacity of our military satellite in-

frastructure. FY 2007 has proven to be a milestone year for TSAT. The program made excellent progress in demonstrating the maturity of its critical technology elements by successfully completing the third of three demonstrations at MIT Lincoln Laboratory (MIT/LL) testing each competing contractor's proposed Laser Communications (or 'lasercom') and next-generation satellite processor/router (NGPR) equipment. The program also completed a successful four-week system design review (SDR) where the government assessed the viability of the architecture designs for each competing contractor on the satellite segment and on the TSAT Mission Operations System (TMOS) ground segment, whose contract was awarded in January 2006.

Based upon the extent and success of risk reduction efforts accomplished thus far on this program, TSAT is prepared to meet a Key Decision Point-B (KDP-B) milestone in order to gain Milestone Decision Authority (MDA) acceptance to proceed into the Preliminary Design Phase of the program's acquisition cycle. In preparation for the KDP-B decision, several in-depth reviews were performed this summer on TSAT, including an Independent Program Assessment, an Independent Cost Evaluation, and a Technical Readiness Assessment. The underlying result of these detailed reviews was that the program structure, budgeting, and technical development are well defined, properly managed and adequately mature enough to support the initiation of preliminary design activities. Additionally, in June 2007, the TSAT program released a Request for Proposals (RFP) on the space segment development contract. The Air Force is reviewing bids from multiple contractors. Based on an Authority to Proceed from the MDA in November 2007, the TSAT program anticipates a contract award announcement as early as the first quarter of FY 2008.

TSAT is on track to successfully meet the KDP-B review in November 2007, award the space segment contract in early FY 2008, begin satellite design work, and continue development of the TMOS segment. The ultimate goal is an FY 2016 first launch of TSAT.

**Research, Development, Test and Evaluation Management Support** - The Air Force's Research, Development, Test and Evaluation (RDT&E) Management Support efforts include projects directed toward support of installation or operations required for general research and development use. The projects include test ranges, military construction, maintenance support of laboratories, operation and maintenance of test aircraft and ships, and studies and analyses in support of the research and development program. An example of Air Force RDT&E management support is the Major Test and Evaluation Investment program, which funds the planning, improvements and modernization for three national asset test centers having over \$10 billion of unique test facilities/capabilities operated and maintained by the Air Force for the Department of Defense (DoD) test and evaluation missions, and available to others having a requirement for their unique capabilities.

Many efforts are contained within the Air Force I&M program, but two examples are the Advanced Airborne Instrumentation Integration (AII) at AAC Eglin AFB, which will provide a common suite of aircraft instrumentation among test centers. AII will provide capabilities to quickly and non-intrusively collect airborne weapon data for developmental and operational test and training that will support future test customers and be standardized among Air Force Test Centers. The key features will be high data rates, smaller size, high reliability with the use of solid state recording units and data handling, and efficient use of the radio frequency spectrum. In addition, the Advanced GPS Range System (AGRS) will provide AFFTC Edwards AFB and AAC Eglin AFB customers with increased Time-Space-Position-Information (TSPI) by upgrading GPS-based Range TSPI systems. AGRS will increase TSPI accuracy (Position, Velocity, and Attitude), use modularized and miniaturized system components upgrade GPS TSPI software for real-time data filtering, processing, and display, and upgrade the data link capability.

**Operational Systems Development** - The Air Force's operational system efforts include projects in support of development acquisition programs or upgrades in SDD. The F-22 Raptor program continued full rate production on the world's only 5<sup>th</sup> generation production line, and it will maintain its role as the key enabler of joint air dominance through an incre-



mental modernization program funded through Operational Systems Development activities. Over 100 aircraft have been delivered through the end of FY 2007. The development program will enhance the air vehicle, engine, and training systems to improve F-22A weapons, communications, and Intelligence Surveillance Reconnaissance (ISR) capabilities to further enhance Global Strike capabilities. Increment 2 is now resident in delivered aircraft and represents the first upgrade over IOC capabilities. FY 2007 activities included development of the Increment 3 suite. A Critical Design Review (CDR) for Increment 3.1, focused on dramatically improving the F-22A Raptor's Air-To-Ground attack capabilities with 4<sup>th</sup> generation synthetic aperture radar and a new weapon, the Small Diameter Bomb, was completed.

The Advanced Medium Range Air-to-Air Missile (AMRAAM) Phase 3 (AIM-120C-7) effort completed SDD in May 2004 and Operational Test (OT) in September 2007. Production for this variant began in the 4<sup>th</sup> Quarter, FY 2004, and will complete in the 2<sup>nd</sup> Quarter, FY 2009. The AIM-120C-7 provides a major upgrade over the AIM-120C-6 guidance section, particularly the use of circular processor cards over previously used rectangular cards. These cards provide significant space savings within the missile for added capability in addition to providing greater processing power.

AMRAAM Phase 4 (AIM-120D) builds on the AIM-120C-7 capability and is progressing. This new AIM-120D missile will add a GPS/INU and a 2-way Data Link to enhance accuracy and control, and thus, increasing weapon effectiveness. In addition, the AIM-120D will have increased range and third party targeting which expands the HOBS launch envelope. The SDD contract was awarded in December 2003. Captive flight testing has been initiated on the F/A-18C/D and F-15C/D. There are currently two proof-of-design (POD) units and five proof-of-manufacturing units supporting simulation/integration labs, production test equipment development, and ground and flight testing.

The Small Diameter Bomb I (SDB I) program will increase the number of kills per platform or sortie (x4) while achieving required effects by improving accuracy and reducing collateral damage over current inventory weapons. SDB I is an incremental development weapon program that entered low rate initial production in FY 2005. The first increment of SDB I will attack fixed and stationary targets using anti-jam/SAASM Inertial Navigation System/Global Positioning Satellite (GPS) aided by a very wide area differential GPS solution and standoff capability. The program successfully completed the IOT&E phase of Seamless Verification in July 2006. The program met Required Assets Available (RAA) in August 2006. SDB I weapon deliveries and F-15E aircraft modifications were completed in time to not only meet RAA requirements, but also a real-world operational deployment whereby 43 weapons have been successfully dropped. The SDB will provide transformational capability to the Air Force by increasing loadout per weapon station on multiple platforms, reducing sorties and minimizing collateral damage.

The SDB I Focused Lethality Munition (FLM), a variant of SDB I, is a Joint Capabilities Technology Development (JCTD) program that will demonstrate the military utility of a low collateral damage warhead integrated into the SDB I weapon. This JCTD will fully leverage the SDB I program to facilitate rapid acquisition. FLM will exploit the Multi-phase Blast Explosive fill and composite case warhead to create a more intense and lethal near-field blast with significantly less warhead fragmentation effects than current weapons. The FLM capability will increase combatant commanders' strike options, particularly in an urban environment, while decreasing collateral damage risk. The FLM JCTD effort began in August 2006 and will deliver a functional prototype weapon in July 2008 and upon a successful Military Utility Assessment, FLM will transition to operational use.



# General Fund

Fiscal Year 2007

Required Supplementary Information



## Statement of Disaggregated Budgetary Resources - General Fund

As of September 30, 2007 and 2006 (amounts in thousands)

	Other	Research, Development, Test & Evaluation	Operation and Maintenance
<b>BUDGETARY FINANCING ACCOUNTS</b>			
<b>BUDGETARY RESOURCES:</b>			
1. Unobligated balance, brought forward, October 1	\$ 4,099	\$ 3,658,594	\$ 1,304,025
2. Recoveries of prior year unpaid obligations	122	523,661	2,425,681
3. Budget authority			
A. Appropriation	404,235	24,740,416	48,401,385
B. Borrowing authority	0	0	0
C. Contract authority	0	0	0
D. Spending authority from offsetting collections			
1. Earned			
a. Earned	14,055	3,220,296	6,145,858
b. Change in receivables from Federal sources	0	-10,279	-474,146
2. Change in unfilled customer orders			
a. Advance received	0	215,189	28,987
b. Without advance from Federal sources	0	52,586	174,301
3. Anticipated for rest of year, without advances	0	0	0
4. Previously unavailable	0	0	0
5. Expenditure transfers from trust funds	0	0	0
E. Subtotal	\$ 418,290	\$ 28,218,208	\$ 54,276,385
4. Nonexpenditure transfers, net, anticipated and actual	-401,461	-11,567	767,949
5. Temporarily not available pursuant to Public Law	0	0	0
6. Permanently not available	0	-291,588	-587,618
<b>7. Total Budgetary Resources</b>	<b>\$ 21,050</b>	<b>\$ 32,097,308</b>	<b>\$ 58,186,422</b>
<b>STATUS OF BUDGETARY RESOURCES:</b>			
<b>8. Obligations incurred</b>			
A. Direct	\$ 2,663	\$ 24,768,002	\$ 50,505,393
B. Reimbursable	13,867	3,453,566	6,115,425
C. Subtotal	16,530	28,221,568	56,620,818
<b>9. Unobligated balance</b>			
A. Apportioned	1,249	3,475,466	169,482
B. Exempt from apportionment	3,271	0	0
C. Subtotal	4,520	3,475,466	169,482
10. Unobligated balance not available	0	400,273	1,396,122
<b>11. Total status of budgetary resources</b>	<b>\$ 21,050</b>	<b>\$ 32,097,307</b>	<b>\$ 58,186,422</b>
<b>CHANGE IN OBLIGATED BALANCE:</b>			
<b>12. Obligated balance, net</b>			
A. Unpaid obligations, brought forward, October 1	1,643	8,037,755	19,025,559
B. Less: Uncollected customer payments from Federal sources, brought forward, October 1	\$ 0	\$ -765,712	\$ -1,659,021
C. Total unpaid obligated balance	1,643	7,272,043	17,366,538
<b>13. Obligations incurred net (+/-)</b>	<b>\$ 16,531</b>	<b>\$ 28,221,568</b>	<b>\$ 56,620,817</b>
<b>14. Less: Gross outlays</b>	<b>-13,580</b>	<b>-26,345,869</b>	<b>-52,328,432</b>
<b>15. Obligated</b>			
A. Actual transfers, unpaid obligations (+/-)	0	0	0
B. Actual transfers, uncollected customer payments from Federal sources (+/-)	0	0	0
C. Total Unpaid obligated balance transferred, net	0	0	0
<b>16. Less: Recoveries of prior year unpaid obligations, actual</b>	<b>\$ -122</b>	<b>\$ -523,661</b>	<b>\$ -2,425,681</b>
<b>17. Change in uncollected customer payments from Federal sources (+/-)</b>	<b>0</b>	<b>-42,306</b>	<b>299,844</b>
<b>18. Obligated balance, net, end of period</b>			
A. Unpaid obligations	4,471	9,380,793	20,892,264
B. Less: Uncollected customer payments	0	-808,018	-1,359,177
C. Total, unpaid obligated balance, net, end of period	4,471	8,572,775	19,533,087
<b>NET OUTLAYS:</b>			
<b>19. Net Outlays</b>			
A. Gross outlays	\$ 13,580	\$ 26,354,869	\$ 52,328,432
B. Less: Offsetting collections	-14,055	-3,435,485	-6,174,845
C. Less: Distributed Offsetting receipts	-140,980	0	0
<b>20. Net Outlays</b>	<b>\$ -141,455</b>	<b>\$ 22,919,384</b>	<b>\$ 46,153,587</b>

Procurement	Military Personnel	Military Construction / Family Housing	2007 Combined	2006 Combined
\$ 9,813,139	\$ 421,054	\$ 1,912,016	\$ 17,112,927	\$ 13,006,208
686,060	200,958	85,459	3,921,941	1,450,906
40,050,972	31,612,389	2,465,300	147,674,697	139,767,610
0	0	0	0	0
0	0	0	0	0
460,706	383,486	13,275	10,237,677	9,255,190
-20,895	-12,429	0	-517,749	-99,279
130,940	0	1,502	376,618	-94,677
23,890	34	0	250,810	-102,493
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
\$ 40,645,613	\$ 31,983,480	\$ 2,480,077	\$ 158,022,053	\$ 148,726,351
49,625	621,942	-165,217	861,271	2,576,690
0	0	0	0	0
-737,554	-129,435	-22,810	-1,769,006	-3,046,233
<u>\$ 50,456,883</u>	<u>\$ 33,097,999</u>	<u>\$ 4,289,525</u>	<u>\$ 178,149,186</u>	<u>\$ 162,713,922</u>
\$ 36,905,597	\$ 32,481,017	\$ 1,862,160	\$ 146,524,833	\$ 136,439,546
501,060	363,560	1,530	10,449,009	9,161,449
<u>37,406,657</u>	<u>32,844,577</u>	<u>1,863,690</u>	<u>156,973,842</u>	<u>145,600,995</u>
12,507,710	20,595	2,399,336	18,473,839	14,998,616
0	0	0	3,271	3,174
<u>12,507,710</u>	<u>20,595</u>	<u>2,399,336</u>	<u>18,577,110</u>	<u>15,001,790</u>
542,515	232,827	26,497	2,598,234	2,111,137
<u>\$ 50,456,882</u>	<u>\$ 33,097,999</u>	<u>\$ 4,289,523</u>	<u>\$ 178,149,186</u>	<u>\$ 162,713,922</u>
\$ 22,892,295	\$ 829,223	\$ 3,202,626	\$ 53,989,101	\$ 51,840,781
-231,950	22,959	0	-2,633,723	-2,835,497
<u>22,660,345</u>	<u>852,182</u>	<u>3,202,626</u>	<u>51,355,378</u>	<u>49,005,284</u>
\$ 37,406,658	\$ 32,844,578	\$ 1,863,690	\$ 156,973,842	\$ 145,600,995
-34,250,410	-31,140,311	-2,020,040	-146,107,640	-142,001,769
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
\$ -686,060	\$ -200,958	\$ -85,459	\$ -3,921,941	\$ -1,450,906
-2,995	12,395	0	266,938	201,773
25,362,483	2,332,531	2,960,818	60,933,360	53,989,101
-234,945	35,354	0	-2,366,785	-2,633,723
<u>25,127,538</u>	<u>2,367,885</u>	<u>2,960,818</u>	<u>58,566,575</u>	<u>51,355,378</u>
\$ 34,250,410	\$ 31,140,311	\$ 2,020,040	\$ 146,107,640	\$ 142,001,769
-591,646	-383,486	-14,777	-10,614,293	-9,160,512
0	0	0	-140,980	-185,423
<u>\$ 33,658,764</u>	<u>\$ 30,756,825</u>	<u>\$ 2,005,263</u>	<u>\$ 135,352,367</u>	<u>\$ 132,655,834</u>



## DISAGGREGATED STATEMENT OF BUDGETARY RESOURCES

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

### REAL PROPERTY DEFERRED MAINTENANCE For Fiscal Year Ended September 30, 2007 (amounts in thousands)

Property Type	Fiscal Year 2007		
	1. Plant Replacement Value	2. Required Work (deferred maintenance)	3. Percentage
1. Category 1: Buildings, Structures, and Utilities	\$ 236,608,198,469	\$ 14,661,965,726	6%
2. Category 2: Buildings, Structures, and Utilities	\$ 14,960,189,031	Note 1	Note 1
3. Category 3: Buildings, Structures, and Utilities (Heritage Assets)	\$ 13,136,217,284	\$ 1,341,827,151	10%

#### Notes:

1. The Air Force does not track deficiency requirements for facilities excess to its mission needs.

#### Use of Q-Rating versus Facilities Sustainment Model (FSM) to reflect Deferred Sustainment Maintenance

2. The use of Q-Rating as a basis of calculated deferred maintenance does not seem prudent. The services Q-Rating data is not a mature dataset as compared to the FSM dataset. We believe that the services will need at least 2 to 3 years to develop a better Q-Rating dataset. With the addition of facility sustainment requirements for this year, we believe the Q-Rating dataset has become even more unstable.
3. At this stage of the Q-Rating development and implementation, facility Q-Ratings can't be readily tied to actual obligations nor does facility Q-Ratings provide a consistent service-wide model based on commercial standards.
4. Based on previous submissions to HQ SAF/FMPS & DFAS-DE, the use of FSM as a benchmark has proven to be a very defensible model in the Air Force Corporate Structure (AFCS). FSM can be linked to actual obligations, is consistent across the services, and uses commercial standards in its development which provides the stability and credibility needed to defend our budgets in the AFCS.
5. The inclusion of the "A" factor to represent "acceptable operating condition" is not currently valid. At this time, there is no dataset which can be used to underpin target Q-Rating percentages nor to identify acceptable operating conditions for specific Air Force facilities.
6. At A=100%, the FY 2007 accumulated deferred sustainment based on Q-Ratings is \$14.7 billion. Though a backlog of \$14.7 billion obviously appears significant, this considerably large requirement adds little value in the AFCS's decision-making process. From our experience, the AFCS will quickly question such a large backlog if used to defend our budget shortfalls. Variable "A" factors would need to be developed to make the proposed deferred maintenance concept feasible. For the purpose of this submittal, the Air Force set A at 100%.

7. Strategically, the use of annual deferred sustainment maintenance based on FSM has already proven to be successful in defending our budgets through the AFCS. In FY 2006, the annual deferred sustainment maintenance based on FSM was at a reasonable level of \$467 million.

### MILITARY EQUIPMENT DEFERRED MAINTENANCE

For Fiscal Year Ended September 30, 2007

(amounts in thousands)

Major Type		
1. Aircraft		\$ 250,953
2. Software		130,936
3. Engines		85,195
4. Non-MSD Exchangeables		33,991
5. Other Major End Items		33,471
6. Missiles		8,065
7. Area Base Maintenance		9,274
8. Storage		879
<b>Total</b>		<b>\$ 562,764</b>

The figures presented are projected deferred maintenance amounts for FY 2007, since the actual data for the FY 2007 GWOT Supplemental was not available.

The figures include Active Air Force, Air National Guard and the Air Force Reserve.

### STEWARDSHIP PLANT, PROPERTY, AND EQUIPMENT (PP&E)

Heritage Assets are items of historical, natural, cultural, educational, or artistic significance (e.g., aesthetic) or items with significant architectural characteristics.

#### HERITAGE ASSETS

For Fiscal Year Ended September 30, 2007

(a)	(b)	(c)	(d)	(e)	(f)
Heritage Asset Categories	Measurement Quantity	FY 2006	Additions	Deletions	FY 2007
Buildings and Structures	Each	4,548	0	457	4,091
Archeological Sites	Sites	1,514	0	89	1,425
Monuments & Memorials	Each	244	0	0	244
Cemeteries	Sites	39	0	0	39
Museums	Each	14	0	1	13
Major Collections	Each	4	0	1	3



## **1. Museums**

The term “museum” means a public or private nonprofit agency or institution organized on a permanent basis for essentially educational or aesthetic purposes, that utilizes a professional staff, owns or utilizes tangible objects, cares for the tangible objects, and exhibits the tangible objects to the public on a regular basis (20 U.S.C. 9172). In accordance with Air Force Mission Directive 29, the National Museum of the U.S. Air Force (NMUSAF) portrays the history and traditions of the USAF through specialized interpretive exhibits and display of USAF historical property, and by operating the USAF’s national museum. The Museum fulfills the Secretary of the Air Force’s statutory responsibility (10 U.S.C. 8013; 16 U.S.C. 432, 461, 10 U.S.C. 2572) for the identification, preservation, and utilization of the USAF’s historical property collection which is an integral component of the national collection.

The National Museum of the United States Air Force, located at Wright-Patterson Air Force Base, Ohio, is the services’ single, authorized national museum. This museum has a professionally-qualified staff and is responsible to the Secretary of the Air Force for the management and stewardship of the national historical collection as part of the United States Air Force Heritage Program (USAFHP). The NMUSAF retains the majority of the national historic collection of artifacts, as well as two dimensional objects (images, graphic arts, printed references, and paper ephemera), so they may be afforded the highest level of professional care as well as exhibition to nearly 1.2 million visitors a year. The NMUSAF has achieved full professional accreditation by the American Association of Museums.

The other 12 reported museums are defined as Air Force Field Museums and are operated by their respective major commands (MAJCOM’s). While they are responsible for Air Force Historical Property on loan from the NMUSAF, they have been limited in both their scope and capabilities. The MAJCOM’s also operate at various base locations small heritage centers and historical exhibits, which are further limited in capabilities and are neither manned nor resourced at professional museum levels. All Air Force field museums have been reported to be in acceptable condition.

The single Air National Guard museum listed in 2006 was an erroneous report and has been deleted per National Guard Bureau (NGB-PAI-H).

## **2. Monuments and Memorials**

Monuments and Memorials are site and structures built to honor and preserve the memory of significant individuals and/or events in history. The 244 memorials and monuments, except for 28, are all located at the Air Force Academy in the Air Gardens and Honor Court. Most of these monuments and memorials honor specific individuals or cadet wings for various accomplishments. The remaining 28 Air Force memorials, all with costs that exceed \$100,000, are located on various Air Force bases throughout the United States. All are reported in acceptable condition.

## **3. Cemeteries**

Cemeteries are maintained on land where the gravesites of prominent historical figures are located. The Air Force has administrative and curatorial responsibilities for 39 cemeteries on its Active Duty bases. The cemeteries are maintained by the bases and are in good condition.

## **4. Archeological Sites**

Archeological Sites are sites that have been identified, evaluated, and determined to be eligible for or are listed on the National Register of Historic Places (NRHP).

As of September 20, 2007, the Air Force has 1,425 archaeological sites listed on or eligible for listing on the NRHP (as reported in the FY 2006 Annual Report to Congress on Federal Archaeological Activity). The Air Force has 10,299 recorded, but unevaluated (potentially eligible) archaeological sites, and 5,238 sites considered not eligible for the Register. A total of 16,962 archaeological sites have been reported from Air Force lands. Eligible and listed sites (heritage assets) are protected from vandalism and looting, and are maintained in good condition on Air Force installations. Heritage asset archaeological sites are subject to a National Historic Preservation Act, Section 106, review and consultation when affected by Air Force undertakings.

## 5. Buildings and Structures

Buildings and Structures includes buildings and structures that are listed on, or eligible for listing on, the NRHP, including Multi-use Heritage Assets. It also includes National Historic Landmarks; buildings or structures that are contributing elements to districts listed on or eligible for the NRHP or a National Historic Landmark District; and buildings and structures designated eligible in the NHRP for purposes of program alternatives.

As of September 20, 2007, the Air Force considers 4,091 buildings and structures as heritage assets (non Capehart-Wherry Era). Of these, 614 are in National Historic Landmarks, 164 are listed on the NRHP, and 3,340 are eligible for listing on the NRHP. Heritage assets, buildings and structures, are maintained by each base civil engineering group and are considered to be in good condition. These buildings and structures are subject to the review and consultation requirements of the NHPA, Section 106, whenever Air Force undertakings might affect their historic characteristics.

As of September 20, 2007, the Air Force considers 15,787 buildings and structures as NRHP listed and eligible buildings and structures. The majority of these are Capehart-Wherry Era (CWE) houses (11,696), which are subject to a recently completed nationwide program comment from the Advisory Council on Historic Preservation which allows the Air Force to demolish or remove all but three CWE houses from the Air Force inventory. We do not consider CWE housing as heritage assets.

## 6. Major Collections

The Air Force has three significant or major collections. The Air Force Art Program Office, on behalf of the Office of the Secretary of the Air Force, manages an extensive Art Collection available to a worldwide audience. The Air Force Academy (AFA) has two separate special collections which contain objects, memorabilia, and documents, as well as distinctive works of original art held in support of academic programs. One less collection from FY 2006 is being reported by the AFA. This collection of artifacts is now included with the national historic collection of the United States Air Force Heritage Program administered by the National Museum of the United States Air Force (NMUSAF). All major collections are reported to be in overall good condition with steady improvements being made in both accountability and storage/display environments.

## STEWARDSHIP LAND

Stewardship Land is land and land rights owned by the Federal Government but not acquired for, or in connection with, items of General PP&E. "Acquired for or in connection with" is defined as including land acquired with the intent to construct General PP&E and land acquired in combination with General PP&E.

**STEWARDSHIP LAND**

For Fiscal Year Ended September 30, 2007

(in thousands of acres)

(a) Land Use	(b) FY 2006	(c) Additions	(d) Deletions	(e) FY 2007
1. Mission	7,705	0	4	7,701
2. Parks & Historic Sites	0	0	0	0
<b>Totals</b>	<b>7,705</b>	<b>0</b>	<b>4</b>	<b>7,701</b>

The Air Force has approximately 7,704,000 acres of mission-essential Stewardship Land under their administration. The beginning balance was (FY 2006 Ending Balance) adjusted by 18,000 acres. During this period of time, various transactions have occurred that decreased the number of acres by approximately 649 acres. Lands purchased by the Air Force with the intent to construct buildings or facilities are considered general plant, property, and equipment (PP&E) and are reported on the balance sheet. All stewardship lands, as reported, are in acceptable condition, based on designated use.

Required Supplementary Information - Part A AT57 - Air Force General Fund Schedule, Part A DoD Intragovernmental Asset Balances. (amounts in thousands)	Treasury Index	Fund Balance with Treasury	Accounts Receivable	Loans Receivable	Investments	Other
Executive Office of the President	11		\$ 2,840			
Department of Agriculture	12		864			
Department of Commerce	13		63			\$ 15,727
Department of the Interior	14		3			96,119
Department of Justice	15		1,543			4,349
Department of Labor	16					
Navy General Fund	17		42,101			
United States Postal Service	18		138			
Department of State	19		17,006			
Department of the Treasury	20	\$ 80,126,396	846		\$ 823	
Army General Fund	21		14,697			183
Office of Personnel Management	24		15			59,980
Federal Communications Commission	27					
Social Security Administration	28					
Library of Congress	3		8			
Nuclear Regulatory Commission	31					
Department of Veterans Affairs	36		269			8
Government Printing Office	4		2			
General Service Administration	47		283			2,660
National Science Foundation	49		3,026			16,709
General Accounting Office	5		4			
Central Intelligence Agency	56		344			
Tennessee Valley Authority	64					
Environmental Protection Agency	68		38			8,045
Department of Transportation	69					1,621
Homeland Security	70		19,879			15,562
Agency for International Development	72		182			
Small Business Administration	73		155			156
Department of Health and Human Services	75		5			394
National Aeronautics and Space Administration	80		6,110			55,206
Department of Energy	89		7,376			7,801
Department of Education	91					
US Army Corps of Engineers	96		63			
Other Defense Organizations General Funds	97		59,131			7,506
Other Defense Organizations Working Capital Funds	97-4930		168,208			11,597
Army Working Capital Fund	97-4930.001		31			
Navy Working Capital Fund	97-4930.002		944			7
Air Force Working Capital Fund	97-4930.003		42,647			120,321
<b>Totals</b>		<b>\$ 80,126,396</b>	<b>\$ 388,821</b>		<b>\$ 823</b>	<b>\$ 423,951</b>



UNITED STATES AIR FORCE

**General Fund**

Required Supplementary Information

Required Supplementary Information - Part B AT57 - Air Force General Fund Schedule, Part B DoD Intragovernmental entity liabilities. (amounts in thousands)	Treasury Index	Accounts Payable	Debts/Borrowings From Other Agencies	Other
Department of Agriculture	12	\$ 1,539		
Department of Commerce	13			
Department of the Interior	14	4,005		
Department of Justice	15	6,807		\$ 3,045
Department of Labor	16			325,949
Navy General Fund	17	5,280		234,131
United States Postal Service	18	12,838		
Department of State	19	11,941		
Department of the Treasury	20	446		230
Army General Fund	21	36,350		111,494
Office of Personnel Management	24	2,220		53,138
Federal Communications Commission	27	36		
Social Security Administration	28	2		
Nuclear Regulatory Commission	31	52		
Department of Veterans Affairs	36	6,188		
General Service Administration	47	148,419		
National Science Foundation	49	3,478		
Tennessee Valley Authority	64	1,942		
Environmental Protection Agency	68	151		
Department of Transportation	69	43,951		
Homeland Security	70	32,692		
Agency for International Development	72	1,642		
Small Business Administration	73	155		
Department of Health and Human Services	75	573		
National Aeronautics and Space Administration	80	7,356		25
Department of Energy	89	39,798		1,202
Department of Education	91	0		
US Army Corps of Engineers	96	918		
Other Defense Organizations General Funds	97	43,599		531,281
Other Defense Organizations Working Capital Funds	97-4930	813,102		1,001
Army Working Capital Fund	97-4930.001	5,610		
Navy Working Capital Fund	97-4930.002	26,312		
Air Force Working Capital Fund	97-4930.003	252,228		418
The General Fund of the Treasury	99			771,412
<b>Totals</b>		<b>\$ 1,509,630</b>		<b>\$ 2,033,326</b>

Required Supplementary Information - Part C AT97 - Air Force General Fund Schedule, Part C DoD Intragovernmental revenue and related costs. (amounts in thousands)	Treasury Index	Earned Revenue
Executive Office of the President	11	\$ 10,772
Department of Agriculture	12	4,657
Department of Commerce	13	753
Department of the Interior	14	3,299
Department of Justice	15	22,046
Navy General Fund	17	237,660
United States Postal Service	18	480
Department of State	19	28,955
Department of the Treasury	20	9,906
Army General Fund	21	300,266
Office of Personnel Management	24	
Library of Congress	3	48
Nuclear Regulatory Commission	31	23
Department of Veterans Affairs	36	1,011
Government Printing Office	4	4
General Service Administration	47	1,012
National Science Foundation	49	62,393
General Accounting Office	5	32
Central Intelligence Agency	56	1,958
Environmental Protection Agency	68	434
Homeland Security	70	125,619
Agency for International Development	72	1,088
Department of Health and Human Services	75	67
National Aeronautics and Space Administration	80	63,672
Department of Energy	89	38,437
US Army Corps of Engineers	96	1,342
Other Defense Organizations General Funds	97	1,693,280
Other Defense Organizations Working Capital Funds	97-4930	1,414,729
Army Working Capital Fund	97-4930.001	1,820
Navy Working Capital Fund	97-4930.002	17,121
Air Force Working Capital Fund	97-4930.003	327,203
DoD Medicare-Eligible Retiree Health Care Fund		181,809
<b>Totals</b>		<b>\$ 4,551,896</b>



UNITED STATES AIR FORCE  
**General Fund**  
Required Supplementary Information

Required Supplementary Information - Part E AT57 - Air Force General Fund Schedule, Part E DoD Intragovernmental non-exchange revenues. (amounts in thousands)	Treasury Index	Accounts Payable	Other
Navy General Fund	17		\$ 12,648
Army General Fund	21		29,764
Other Defense Organizations General Funds	97	\$ 237,609	
Other Defense Organizations Working Capital Funds	97-4930	68,384	
Air Force Working Capital Fund	97-4930.003	282,000	2,192
<b>Totals</b>		<b>\$ 587,993</b>	<b>\$ 44,604</b>



# General Fund

Fiscal Year 2007

Audit Opinion



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

November 8, 2007

MEMORANDUM FOR PRINCIPAL DEPUTY ASSISTANT SECRETARY OF THE  
AIR FORCE (FINANCIAL MANAGEMENT)

SUBJECT: Independent Auditor's Report on the FY 2007 Air Force General Fund Financial  
Statements (Report No. D-2008-010)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying Air Force General Fund Consolidated Balance Sheets as of September 30, 2007 and 2006, and the related Consolidated Statements of Net Cost, the Consolidated Statements of Changes in Net Position, and the Combined Statements of Budgetary Resources and related notes for the fiscal years then ended.<sup>1</sup> The basic financial statements are the responsibility of Air Force management. The Air Force is also responsible for implementing effective internal control and for complying with laws and regulations. We are unable to express an opinion on the Air Force General Fund FY 2007 Financial Statements because of limitations on the scope of our work. Thus, the basic financial statements may be unreliable. In addition to our disclaimer of opinion on the basic financial statements, we are including the required Report on Internal Control and Compliance with Laws and Regulations. The Report on Internal Control and Compliance with Laws and Regulations is an integral part of our disclaimer of opinion on the basic financial statements and should be considered in assessing the results of our work.

**Disclaimer of Opinion on the Basic Financial Statements**

The Principal Deputy Assistant Secretary of the Air Force (Financial Management) acknowledged to us that the Air Force General Fund FY 2007 Financial Statements would not substantially conform to accounting principles generally accepted in the United States of America (GAAP), and that Air Force financial management and feeder systems were unable to adequately support material amounts on the basic financial statements as of September 30, 2007. Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to performing only those audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. Therefore, we did not perform auditing procedures required by U.S. Government auditing standards and Office of Management and Budget Bulletin (OMB) No. 07-04 to determine whether material amounts on the basic financial statements were fairly presented. Prior audits have identified, and the Air Force has also acknowledged, the long-standing material internal control weaknesses identified in the Summary of Internal Control. These pervasive material weaknesses may affect the reliability of certain information contained in the basic financial statements—much of which is taken from the same data sources as the basic financial statements.<sup>2</sup> Therefore, we are unable to express, and we do not express, an opinion on the basic financial statements. Further, the purpose of the audit was not to express an opinion on Management Discussion and Analysis, Required Supplementary Stewardship Information,

<sup>1</sup> Beginning in FY 2007, OMB Circular A-136 requires entities to present the Statement of Financing as a note. It is no longer considered a basic statement.

<sup>2</sup> The basic financial statements include the basic statements, Management Discussion and Analysis, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Accompanying Information.

Required Supplementary Information, Other Accompanying Information, and Performance Measures accompanying the basic financial statements. Accordingly, we express no opinion on that information.

**Summary of Internal Control**

In planning our work, we considered Air Force General Fund internal controls over financial reporting and compliance with applicable laws and regulations. We did this to determine our procedures for auditing the basic financial statements and to comply with OMB guidance, but our purpose was not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance with applicable laws and regulations. However, previously identified significant deficiencies, all of which are material, continue to exist in the following areas:

- **Financial Management Systems**
- **Operating Materials and Supplies**
- **General Property, Plant, and Equipment**
- **Government-Furnished and Contractor-Acquired Material**
- **Environmental Liabilities**
- **Intragovernmental Eliminations**
- **Other Accounting Entries**
- **Statement of Net Costs**
- **Reconciliation of Net Cost of Operations to Budget**

A material weakness is a significant deficiency or a combination of significant deficiencies, resulting in more than a remote<sup>3</sup> likelihood that a material misstatement of the basic financial statements will not be prevented or detected.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, adversely affecting the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles. The following is a list of significant deficiencies identified during FY 2007:

- **Reimbursable Programs**
- **Accounts Receivable Financial Reporting**
- **Accounts Payable Financial Reporting**

Our internal control work (conducted as part of prior audits) would not necessarily disclose all significant deficiencies. The Attachment offers additional details on these significant deficiencies.

<sup>3</sup> The term "remote" is defined as "the chance of the future event or events occurring is slight." Therefore, the likelihood of an event is "more than remote" when it is at least reasonably possible.



### Summary of Compliance with Laws and Regulations

Our work to determine compliance with selected provisions of applicable laws and regulations related to financial reporting was limited because management acknowledged that instances of noncompliance identified in prior audits continue to exist. The Principal Deputy Assistant Secretary of the Air Force (Financial Management) acknowledged to us that Air Force financial management systems do not substantially comply with Federal financial management system requirements, GAAP, and the U.S. Government Standard General Ledger at the transaction level. Therefore, we did not determine whether Air Force was in compliance with all applicable laws and regulations related to financial reporting. Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion. See the Attachment for additional details on compliance with laws and regulations.

### Management's Responsibilities

Management is responsible for:

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

We provided a draft of this report to the Principal Deputy Assistant Secretary of the Air Force (Financial management) who then provided us technical comments, which we incorporated as appropriate. Air Force officials expressed their continuing commitment to address the problems this report outlines.

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

Attachment:  
As stated

## Report on Internal Control and Compliance with Laws and Regulations

### Internal Control

Management is responsible for implementing and maintaining effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly; that the requirements of applicable laws and regulations are met; and that assets are safeguarded against misappropriation and abuse. Our purpose was not to, and we do not, express an opinion on internal control over financial reporting. However, we have identified the following material weaknesses that could adversely affect Air Force financial reporting.

**Previously Identified Material Weaknesses:** Management acknowledged that previously identified significant deficiencies, all of which are material, continued to exist in the following areas.

**Financial Management Systems.** Statement of Federal Financial Accounting Concepts No. 1, "Objectives of Federal Financial Reporting," requires that financial management system controls be adequate to ensure that transactions are executed in accordance with budgetary and financial laws and other requirements, are consistent with the purposes authorized, and are recorded in accordance with Federal accounting standards. This statement also requires that financial management system controls ensure that assets are properly safeguarded to deter fraud, waste, and abuse, and performance measurement information is adequately supported. The Principal Deputy Assistant Secretary of the Air Force (Financial Management) acknowledged that many Air Force financial management systems do not substantially comply with Federal financial management system requirements. Air Force financial management and feeder systems were not designed to collect and record financial information based on a full accrual accounting basis. Until these systems are updated to collect and report financial information in compliance with generally accepted accounting principles, Air Force financial reporting will be based on budgetary transactions and non-financial feeder systems.

**Operating Materials and Supplies.** The Air Force is required by the Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property," to use historical cost to value its operating materials and supplies inventory. This statement also requires that operating materials and supplies be expensed when the items are consumed. The Air Force has acknowledged that significant amounts of operating materials and supplies are valued using standard prices and the consumption method is not always used to recognize the related expense. Accordingly, management is not certain that the operating materials and supplies balances reported in its basic financial statements are accurate.

**General Property, Plant, and Equipment.** The Air Force is required by Statement of Federal Financial Accounting Standards No. 6, "Accounting for Property, Plant, and Equipment," to record general property, plant, and equipment using acquisition cost, capitalize improvement costs, and recognize depreciation expense. However, Air Force has acknowledged that, despite its implementation of a new system to improve its controls over recording real property, construction-in-progress, and related expenses, its controls need additional improvement for its financial reporting to become compliant.

**Government-Furnished and Contractor-Acquired Material.** Statement of Federal Financial Accounting Standards No. 11, "Amendments to Accounting for Property, Plant, and Equipment," requires that property and equipment in the possession of a contractor for use in accomplishing a contract be considered Government property. Government property should be

Attachment



accounted for based on the nature of the item, regardless of who has possession. The Air Force has acknowledged that its balance does not include the cost of all Government-furnished material in the hands of contractors where such value exceeds the capitalization threshold. As a result, the value of Air Force property and material in the possession of contractors is not reliably reported.

**Environmental Liabilities.** The Air Force is not currently able to support its environmental cleanup cost estimates as recorded in the Air Force Real Property Agency management information system. This system provides unsupported cost information for reporting in the year-end financial reports.

**Intragovernmental Eliminations.** Air Force accountants cannot always identify intragovernmental trading partners when recording transactions. Thus, the Air Force cannot properly eliminate all transactions among its internal organizational elements. In addition, the Air Force cannot reconcile intragovernmental accounts receivable, accounts payable, and revenues for transactions between its DoD and other Federal trading partners. This may prevent the Air Force from properly eliminating all of its intragovernmental transactions.

**Other Accounting Entries.** The Air Force acknowledged that it continues to enter material amounts of accounting adjustments that are not adequately supported. Additionally, there are material transactions that the Air Force has not properly recorded in the accounting records underlying the basic financial statements or the disclosed notes to the basic financial statements. The lack of adequate supporting documentation for adjustments may prevent the related financial statement amounts from being audited.

**Statement of Net Cost.** Statement of Federal Financial Accounting Concepts No. 2, "Entity and Display," requires that the Statement of Net Cost present gross and net cost information for major organizations and programs and that the data related to their outputs and outcomes. The Air Force acknowledged the amounts reported in its Statement of Net Cost are accumulated by major appropriation groups funded by Congress and not by major organizations and programs as required. In addition, the Air Force does not accumulate cost information in accordance with generally accepted accounting principles. The amounts presented for General Fund are based on budgetary obligations, disbursements, and collections with adjustments made for only major items of known accruals and imputed expenses. Thus, the Statement of Net Cost may not report all actual costs.

**Reconciliation of Net Cost of Operations to Budget.** Statement of Federal Financial Accounting Standards No. 7, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting," states the Reconciliation of Net Costs of Operations to Budget (in the footnotes to the basic financial statements) should reconcile resources obligated during the accounting period to the net cost of operations for that period. However, the Air Force acknowledged that the amounts presented in the Consolidated Statement of Net Costs are based on budgetary obligations and disbursements and collection transactions with adjustments only for major items of known accruals and imputed expenses. Specifically, budgetary amounts are not in agreement with proprietary expenses and assets capitalized.

**Significant Deficiencies Identified During FY 2007.** During FY 2007, Air Force management identified the following significant deficiencies.

**Reimbursable Programs.** Statement of Federal Financial Accounting Concepts No. 1, "Objectives of Federal Financial Reporting," requires the Air Force to track the cost of performing work reimbursed by other Government entities or by nonfederal customers. Further,

costs are defined as a measure of resources (personnel, material, and equipment) used to accomplish the work. The Air Force has acknowledged that its reimbursable programs may be improperly paying and not being properly reimbursed for all billable costs incurred in the fulfillment of reimbursable orders. Specifically, the Air Force is not always able to identify logistical, contractual, or labor costs incurred in support of reimbursable orders.

**Accounts Receivable Financial Reporting.** The Air Force is unable to have assurance on the Accounts Receivable financial statement line item because of weaknesses in the intragovernmental trading partner eliminations, Foreign Military Sales, and supporting documentation. These deficiencies result in the inability to properly reconcile and support the validity of Accounts Receivable.

**Accounts Payable Financial Reporting.** The Air Force cannot assure the amount of Accounts Payable reported on the basic financial statements due to financial system internal control weaknesses. These weaknesses do not allow the Air Force to accurately reconcile or support entries into the Accounts Payable reported balance.

These financial management deficiencies may cause inaccurate management information. As a result, Air Force management decisions based in whole or in part on this information may be adversely affected. Financial information reported by the DoD may also contain misstatements resulting from these deficiencies.



### Compliance with Laws and Regulations

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

### Audit Disclosures

The Principal Deputy Assistant Secretary of the Air Force (Financial Management) acknowledged to us on February 20 and November 8, 2007, that the Air Force financial management and feeder systems cannot provide adequate evidence supporting various material amounts on the basic financial statements, do not fully comply with GAAP and OMB Circular A-136, "Financial Reporting Requirements," and do not record transactions initially to United States Standard General Ledger accounts. The Federal Financial Management Improvement Act of 1996 requires DoD to establish and maintain financial management systems that comply substantially with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. For fiscal year 2007, the Air Force did not fully comply with the Federal Financial Management Improvement Act.

Therefore, we did not perform detailed testing related to previously reported material weaknesses. In addition, we did not perform audit work related to the provisions of laws and regulations identified in OMB Bulletin No. 07-04, "Audit Requirements for Federal Financial Statements," September 4, 2007, Appendix E, "General Laws."

This report does not include recommendations to correct the material internal control weaknesses and instances of noncompliance with laws and regulations because either previous audit reports contained recommendations for corrective actions or audit projects currently in process will include appropriate recommendations.



# Working Capital Fund Principal Statements

## Fiscal Year 2007

The FY 2007 Department of the Air Force Working Capital Fund Principal Statements and related notes are presented in the format prescribed by the Department of Defense Financial Management Regulation 7000.14-R, Volume 6B. The statements and related notes summarize financial information for individual activity groups and activities within the Working Capital Fund for the fiscal year ending September 30, 2007, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2006.

The following statements comprise the Department of the Air Force Working Capital Fund Principal Statements:

- Consolidated Balance Sheet

The Consolidated Balance Sheet presents as of September 30, 2007 and 2006 those resources owned or managed by the Air Force which are available to provide future economic benefits (assets); amounts owed by the Air Force that will require payments from those resources or future resources (liabilities); and residual amounts retained by the Air Force, comprising the difference (net position).

- Consolidated Statement of Net Cost

The Consolidated Statement of Net Cost presents the net cost of the Air Force's operations for the years ended September 30, 2007 and 2006. The Air Force's net cost of operations includes the gross costs incurred by the Air Force less any exchange revenue earned from Air Force activities.

- Consolidated Statement of Changes in Net Position

The Consolidated Statement of Changes in Net Position presents the change in the Air Force's net position resulting from the net cost of Air Force's operations, budgetary financing sources other than exchange revenues, and other financing sources for the years ended September 30, 2007 and 2006.

- Combined Statement of Budgetary Resources

The Combined Statement of Budgetary Resources presents the budgetary resources available to the Air Force during FY 2007 and 2006, the status of these resources at September 30, 2007 and 2006, and the outlay of budgetary resources for the years ended September 30, 2007 and 2006.

The Principal Statements and related notes have been prepared to report financial position pursuant to the requirements of the Chief Financial Officers Act of 1990, the Government Management Reform Act of 1994, and the Office of Management and Budget's Circular A-136, "Financial Reporting Requirements."



## Consolidated Balance Sheet - Working Capital Fund

As of September 30, 2007 and 2006 (\$ in thousands)

	2007 Consolidated	2006 Consolidated
<b>1. ASSETS (Note 2)</b>		
A. Intragovernmental:		
1. Fund Balance with Treasury (Note 3)		
a. Entity	\$ 1,287,299	\$ 1,357,976
b. Non-Entity Seized Iraqi Cash	0	0
c. Non-Entity-Other	0	0
2. Investments (Note 4)	0	0
3. Accounts Receivable (Note 5)	330,378	420,073
4. Other Assets (Note 6)	1,248	5,218
5. Total Intragovernmental Assets	\$ 1,619,025	\$ 1,783,267
B. Cash and Other Monetary Assets (Note 7)	\$ 0	\$ 0
C. Accounts Receivable, Net (Note 5)	117,808	232,314
D. Loans Receivable (Note 8)	0	0
E. Inventory and Related Property, Net (Note 9)	34,517,432	34,530,876
F. General Property, Plant and Equipment, Net (Note 10)	1,091,070	1,169,165
G. Investments (Note 4)	0	0
H. Other Assets (Note 6)	319,462	541,143
<b>4. TOTAL ASSETS</b>	<b>\$ 37,664,797</b>	<b>\$ 38,256,765</b>
<b>3. LIABILITIES (Note 11)</b>		
A. Intragovernmental		
1. Accounts Payable (Note 12)	\$ 117,965	\$ 171,623
2. Debt (Note 13)	0	0
3. Other Liabilities (Note 15 & 16)	135,036	174,216
4. Total Intragovernmental Liabilities	\$ 253,001	\$ 345,839
B. Accounts Payable (Note 12)	\$ 946,756	\$ 494,347
C. Military Retirement and Other Federal Employment Benefits (Note 17)	228,900	227,035
D. Environmental and Disposal Liabilities (Note 14)	0	0
E. Loan Guarantee Liability (Note 8)	0	0
F. Other Liabilities (Note 15 & Note 16)	714,711	1,197,430
<b>4. TOTAL LIABILITIES</b>	<b>\$ 2,143,368</b>	<b>\$ 2,264,651</b>
<b>5. NET POSITION</b>		
A. Unexpended Appropriations - Earmarked Funds (Note 23)	\$ 0	\$ 0
B. Unexpended Appropriations - Other Funds	4,558	0
C. Cumulative Results of Operations - Earmarked Funds	0	0
D. Cumulative Results of Operations - Other Funds	35,516,871	35,992,114
<b>6. TOTAL NET POSITION</b>	<b>\$ 35,521,429</b>	<b>\$ 35,992,114</b>
<b>7. TOTAL LIABILITIES AND NET POSITION</b>	<b>\$ 37,664,797</b>	<b>\$ 38,256,765</b>

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

## Consolidated Statement of Net Cost - Working Capital Fund

As of September 30, 2007 and 2006 (\$ in thousands)

	2007 Consolidated	2006 Consolidated
	<hr/>	<hr/>
<b>1. Program Costs (Note 18)</b>		
A. Gross Costs	\$ 10,735,131	\$ 8,671,960
B. (Less: Earned Revenue)	-10,431,762	-10,783,023
C. Net Program Costs	<hr/> \$ 303,369	<hr/> \$ -2,111,063
<b>2. Cost Not Assigned to Programs</b>	0	0
<b>3. (Less: Earned Revenue Not Attributable to Programs)</b>	0	0
<b>4. Net Cost of Operations</b>	<hr/> <b>\$ 303,369</b>	<hr/> <b>\$ -2,111,063</b>

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



## Consolidated Statement of Changes in Net Position - Working Capital Fund

As of September 30, 2007 and 2006 (\$ in thousands)

	2007 Earmarked Funds	2007 All Other Funds	2007 Eliminations
<b>CUMULATIVE RESULTS OF OPERATIONS (Note 19)</b>			
<b>1. Beginning Balances</b>	\$ 0	\$ 35,992,114	\$ 0
<b>2. Prior Period Adjustments</b>			0
A. Changes in accounting principles (+/-)	0	0	0
B. Corrections of errors (+/-)	0	0	0
<b>3. Beginning balances, as adjusted</b>	\$ 0	\$ 35,992,114	\$ 0
<b>4. Budgetary Financing Sources</b>			0
A. Other adjustments (rescissions, etc.)	0	0	0
B. Appropriations used	0	39,324	0
C. Nonexchange revenue	0	0	0
D. Donations and forfeitures of cash and cash equivalents	0	0	0
E. Transfers-in/out without reimbursement	0	-382,000	0
F. Other budgetary financing sources	0	0	0
<b>5. Other Financing Sources</b>			0
A. Donations and forfeitures of property	0	0	0
B. Transfers-in/out without reimbursement (+/-)	0	2,192	0
C. Imputed financing from costs absorbed by others	0	168,610	0
D. Other (+/-)	0	0	0
<b>6. Total financing Sources</b>	\$ 0	\$ -171,874	\$ 0
<b>7. Net Cost of Operations (+/-)</b>	0	303,369	0
<b>8. Net Change</b>	0	-475,243	0
<b>9. Cumulative Results of Operations</b>	0	35,516,871	0
<b>UNEXPENDED APPROPRIATIONS</b>			
<b>10. Beginning Balances</b>	\$ 0	\$ 0	\$ 0
<b>11. Prior Period Adjustments</b>			0
A. Changes in accounting principles	0	0	0
B. Corrections of errors	0	0	0
<b>12. Beginning balances, as adjusted</b>	\$ 0	\$ 0	\$ 0
<b>13. Budgetary Financing Sources</b>			0
A. Appropriations received	0	44,054	0
B. Appropriations transferred-in/out	0	0	0
C. Other adjustments (recissions, etc)	0	-172	0
D. Appropriations used	0	-39,324	0
<b>14. Total Budgetary Financing sources</b>	0	4,558	0
<b>15. Unexpended Appropriations</b>	0	4,558	0
<b>16. Net Position</b>	<u>\$ 0</u>	<u>\$ 35,521,429</u>	<u>\$ 0</u>

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

2007 Consolidated	2006 Earmarked Funds	2006 All Other Funds	2006 Eliminations	2006 Consolidated
\$ 35,992,114	\$ 0	\$ 33,774,838	\$ 0	\$ 33,774,838
0	0	0	0	0
0	0	0	0	0
<u>\$ 35,992,114</u>	<u>\$ 0</u>	<u>\$ 33,774,838</u>	<u>\$ 0</u>	<u>\$ 33,774,838</u>
0	0	0	0	0
39,324	0	48,389	0	48,389
0	0	0	0	0
0	0	0	0	0
-382,000	0	-106,784	0	-106,784
0	0	0	0	0
0	0	0	0	0
2,192	0	0	0	0
168,610	0	164,609	0	164,609
0	0	0	0	0
<u>\$ -171,874</u>	<u>\$ 0</u>	<u>\$ 106,214</u>	<u>\$ 0</u>	<u>\$ 106,214</u>
303,369	0	-2,111,062	0	-2,111,062
<u>-475,243</u>	<u>0</u>	<u>2,217,276</u>	<u>0</u>	<u>2,217,276</u>
<u>35,516,871</u>	<u>0</u>	<u>35,992,114</u>	<u>0</u>	<u>35,992,114</u>
\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
0	0	0	0	0
0	0	0	0	0
<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>
44,054	0	48,577	0	48,577
0	0	0	0	0
-172	0	-188	0	-188
-39,324	0	-48,389	0	-48,389
4,558	0	0	0	0
4,558	0	0	0	0
<u><u>\$ 35,521,429</u></u>	<u><u>\$ 0</u></u>	<u><u>\$ 35,992,114</u></u>	<u><u>\$ 0</u></u>	<u><u>\$ 35,992,114</u></u>

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



## Combined Statement of Budgetary Resources - Working Capital Fund

As of September 30, 2007 and 2006 (\$ in thousands)

	2007 Combined	2006 Combined
<b>BUDGETARY FINANCING ACCOUNTS (Note 20)</b>		
<b>BUDGETARY RESOURCES:</b>		
1. Unobligated balance, brought forward, October 1	\$ 925,137	\$ 292,678
2. Recoveries of prior year unpaid obligations	23,358	79,238
3. Budget authority		
A. Appropriation	44,054	48,577
B. Borrowing authority	0	0
C. Contract authority	9,804,575	9,857,832
D. Spending authority from offsetting collections		
1. Earned		
a. Collected	14,106,630	15,953,188
b. Change in receivables from Federal sources	-373,583	-43,158
2. Change in unfilled customer orders		
a. Advance received	-40,165	10,419
b. Without advance from Federal sources	230,560	-936,323
3. Anticipated for rest of year, without advances	0	0
4. Previously unavailable	0	0
5. Expenditure transfers from trust funds	0	0
E. Subtotal	23,772,071	24,890,535
4. Nonexpenditure transfers, net, anticipated and actual	-382,000	-106,784
5. Temporarily not available pursuant to Public Law	0	0
6. Permanently not available	-9,162,481	-8,457,316
<b>7. Total Budgetary Resources</b>	<b>\$ 15,176,085</b>	<b>\$ 16,698,351</b>
<b>STATUS OF BUDGETARY RESOURCES:</b>		
8. Obligations incurred:		
A. Direct	\$ 0	\$ 0
B. Reimbursable	14,102,303	15,773,214
C. Subtotal	14,102,303	15,773,214
9. Unobligated balance:		
A. Apportioned	1,073,782	925,137
B. Exempt from apportionment	0	0
C. Subtotal	1,073,782	925,137
10. Unobligated balance not available	0	0
<b>11. Total status of budgetary resources</b>	<b>\$ 15,176,085</b>	<b>\$ 16,698,351</b>
<b>CHANGE IN OBLIGATED BALANCE:</b>		
12. Obligated balance, net		
A. Unpaid obligations, brought forward, October 1	8,603,483	8,621,328
B. Less: Uncollected customer payments from Federal sources, brought forward, October 1	\$ -3,987,910	\$ -4,967,392
C. Total unpaid obligated balance	4,615,933	3,653,936
13. Obligations incurred net (+/-)	\$ 14,102,303	\$ 15,773,214
14. Less: Gross outlays	-13,798,923	-15,711,459
15. Obligated balance transferred, net		
A. Actual transfers, unpaid obligations (+/-)	0	0
B. Actual transfers, uncollected customer payments from Federal sources (+/-)	0	0
C. Total Unpaid obligated balance transferred, net	0	0
16. Less: Recoveries of prior year unpaid obligations, actual	-23,358	-79,238
17. Change in uncollected customer payments from Federal sources (+/-)	143,023	979,482
18. Obligated balance, net, end of period		
A. Unpaid obligations	8,883,865	8,603,843
B. Less: Uncollected customer payments (+/-) from Federal sources (-)	-3,844,887	-3,987,910
C. Total, unpaid obligated balance, net, end of period	5,038,978	4,615,933
<b>NET OUTLAYS</b>		
<b>19. Net Outlays:</b>		
A. Gross outlays	13,798,923	15,711,459
B. Less: Offsetting collections	-14,066,465	-15,963,606
C. Less: Distributed Offsetting receipts	0	0
<b>20. Total Net Outlays</b>	<b>\$ -267,542</b>	<b>\$ -252,147</b>

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



# Working Capital Fund

Fiscal Year 2007

## Notes to the Principal Statements

Notes to the financial statements communicate information essential for fair presentation of the financial statements that is not displayed on the face of the financial statements.



## Note 1. Significant Accounting Policies

### 1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the United States Air Force Working Capital Fund (AFWCF), as required by the “Chief Financial Officers Act of 1990,” expanded by the “Government Management Reform Act of 1994,” and other appropriate legislation. The financial statements have been prepared from the books and records of AFWCF in accordance with the “Department of Defense (DoD) Financial Management Regulation (FMR),” the Office of Management and Budget (OMB) Circular 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, DoD no longer publishes consolidating/combining financial statements. The accompanying financial statements account for all resources for which AFWCF is responsible unless otherwise noted.

The AFWCF is unable to fully implement all elements of GAAP and OMB Circular A-136 due to limitations of its financial and nonfinancial management processes and systems that feed into the financial statements. The AFWCF derives its reported values and information for major asset and liability categories largely from nonfinancial systems, such as inventory and logistic 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 AFWCF continues to implement process and system improvements addressing these limitations.

The AFWCF currently has eight auditor identified financial statement material weaknesses: (1) financial and nonfinancial feeder systems do not contain an adequate audit trail for the proprietary and budgetary accounts, (2) AFWCF may have material amounts of account adjustments that are not adequately supported, (3) AFWCF cannot accurately identify all intragovernmental transactions by customer, which is required for eliminations when preparing consolidated financial statements, (4) the value of the AFWCF government furnished and contractor acquired material and equipment may not be accurately reported, (5) AFWCF General Property, Plant, and Equipment (PP&E) may not be accurately valued, (6) operating materials and supplies (OM&S) are not reflected at historical cost, (7) cost of goods sold and work in progress are not recorded in accordance with the Statement of Federal Financial Accounting Standards (SFFAS) No. 3, “Accounting for Inventory and Related Property,” and (8) supply management systems do not provide sufficient audit trails to confirm and value the in-transit inventory reported as part of inventory held for sale on the Consolidated Balance Sheet.

### 1.B. Mission of the Reporting Entity

The United States Air Force was created on September 18, 1947, by the “National Security Act of 1947.” The “National Security Act Amendments of 1949” established the DoD and made the Air Force a department within DoD. The overall mission of the Air Force is to deliver sovereign options for the defense of the United States of America and its global interest—to fly and fight in air, space, and cyberspace. Our priorities are: (1) win the Global War on Terror, (2) develop and care for our airmen, and (3) modernize and recapitalize our aircraft and equipment.

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

Since FY 2006, AFWCF operations consist of two major activity groups: Supply Management Activity Group (SMAG) and Depot Maintenance Activity Group (DMAG). Prior to FY 2006, there was a third activity group called Information Services Activity Group (ISAG). The ISAG was discontinued from AFWCF at the end of FY 2005. As of September 30,

2007, the remaining ISAG unfilled customer orders and Balance Sheet accounts were liquidated resulting in official closure of accounting records and financial statements.

The SMAG manages and finances the majority of Air Force supply requirements. Exceptions include an item financed with a procurement appropriation or when financing by other means has been deemed to be more economical and efficient. A stock fund operates as a revolving fund replenishing inventories with funds received from sales to customers. All AFWCF supply activities establish prices based on full cost recovery. If an operating loss or gain is incurred, the activity will make the appropriate adjustment in following year's prices to recoup the loss or return the gain to their customers.

There are four active business activities in SMAG: (1) Material Support Division (MSD), (2) General Support Division (GSD), (3) Medical-Dental Division, and (4) Air Force Academy Division. The Fuels Division was discontinued in FY 2001, and their accounting records were closed September 30, 2007.

A brief description is provided below for the four active SMAG business activities.

- MSD manages over 130 thousand depot level repair and unique consumable items to support Air Force weapon systems.
- GSD manages over 1.5 million consumable supply items, which support field and depot maintenance of aircraft, ground and airborne communication, and electronic systems.
- Medical-Dental manages over 7 thousand different items, which are used to support medical and dental supply and equipment requirements.
- Air Force Academy manages the procurement of uniforms and uniform accessories for sale to cadets.

The DMAG repairs weapon systems and spare parts that ensure readiness in peacetime and provide sustainment to combat forces in wartime. In peacetime, the Air Force enhances readiness by efficiently and economically repairing, overhauling, and modifying aircraft, engines, missiles, depot level reparables, and software to meet customer demands. Depots have unique skills and equipment required to support and overhaul both new, complex components as well as aging weapon systems. An extremely important facet of the depots is that during wartime or contingencies, the Air Force can surge repair operations and realign capacity to support the war fighters' immediate needs. This is achieved by employing the unique strengths of organic (in-house) and contracted (contract) repair resources. All AFWCF depot activities establish rates based on full cost recovery. If an operating loss or gain is incurred, the activity will make the appropriate adjustment in following year's rates to recoup the loss or return the gain to their customers.

### **1.C. Appropriations and Funds**

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

The AFWCF receives a special appropriation for the procurement of Medical-Dental War Readiness Material (WRM).

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 WCF as an infusion of cash when revenues are



inadequate to cover costs within the corpus.

Operations of the activities within AFWCF are financed by two working capital fund types, operating authority and contract authority. Operating authority is used for the daily recurring business operating expenses incurred to produce the maintenance service being demanded. Contract authority is used to procure supply and Capital Investment Program (CIP) requirements. The CIP requirements are classified into four categories: (1) equipment, (2) software, (3) hardware, and (4) minor construction. Equipment, software, and hardware CIP requirements must be greater than \$250 thousand and have a useful life of more than two years. The minor construction threshold is \$100 thousand. These items are currently depreciated over the expected life of the asset with zero salvage value.

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

For FY 2007, AFWCF's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of AFWCF'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 AFWCF's financial and nonfinancial legacy systems were designed to record information on a budgetary basis.

The DoD 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 AFWCF's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, AFWCF's financial data will be derived from budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and accruals made for major items such as payroll expenses, accounts payable, and environmental liabilities.

In addition, DoD 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 DoD is working towards a cost reporting methodology that meets the need for cost information required by SFFAS No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government."

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

The SMAG recognizes revenue from the sale of inventory items and receipt of direct reimbursement for the purchase of initial and readiness spares by customers. Revenue from the sale of inventory is recognized at the time of sale. Revenue from the receipt of direct reimbursements is recognized upon receipt from the General Fund.

The DMAG (organic) recognizes revenue according to the percentage of completion method. The DMAG (contract) recognizes revenue based on the number of units produced multiplied by the unit sales price which is recognized upon completion of the repair. Due to the anticipated closure of DMAG (contract) activity in FY 2008, it is not cost-effective to implement system modifications to support the percentage of completion method.

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

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. However, because AFWCF's financial and nonfinancial feeder systems were not designed to collect and record financial informa-

tion on the full accrual accounting basis, accruals are made for major items such as payroll expenses, accounts payable, environmental liabilities, and unbilled revenue. In the case of OM&S, operating expenses are generally recognized when the items are purchased. Efforts are underway to transition towards 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 DoD or between two or more federal agencies. However, AFWCF cannot accurately eliminate intragovernmental transactions by customer because AFWCF's systems do not track at the transaction level. Generally, seller entities within DoD provide summary seller side balances for revenue, accounts receivable, and unearned revenue to the buyer side internal DoD accounting offices. In most cases, the buyer side records are adjusted to agree with DoD seller side balances. IntraDoD intragovernmental balances are then eliminated. The volume of intragovernmental transactions is so large that after the fact reconciliation cannot be accomplished effectively with existing or foreseeable resources. The DoD is developing long-term system improvements to ensure accurate intragovernmental information, to include sufficient upfront edits and controls eliminating the need for after the fact reconciliations.

The U.S. Treasury Financial Management Service is responsible for eliminating transactions between DoD 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 Policy Guide” provide guidance for reporting and reconciling intragovernmental balances. While AFWCF is unable to fully reconcile intragovernmental transactions with all federal partners, AFWCF is able to reconcile balances pertaining to 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 of the Federal Government is not included. The Federal Government does not apportion debt and its related costs to federal agencies. The DoD’s financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

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

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

Each year, AFWCF 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, DoD has authority to sell defense articles and services to foreign countries and international organizations, generally at no profit or loss to the U.S. Government. Payment in U.S. dollars is required in advance.

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

The AFWCF’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 AFWCF’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 the 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 AFWCF's recorded balance in the FBWT accounts and U.S. Treasury's FBWT accounts sometimes result and are subsequently reconciled.

The Air Force has hired an independent public accounting firm to audit the AFWCF Fund Balance with Treasury (FBWT) reconciliation process as directed in Department of Defense (DoD) Instruction 7600.02, "Audit Policies.

### **1.J. Foreign Currency**

Not Applicable

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

As presented in the Balance Sheet, accounts receivable includes three categories: accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. The DoD does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies 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/voll/07-03.pdf>.

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

Not Applicable

### **1.M. Inventories and Related Property**

The AFWCF values 99% of its resale inventory using the moving average cost method. The AFWCF reports the remaining 1% of resale inventories at 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, AFWCF is continuing to transition the remaining 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 AFWCF 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, installation, 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 AFWCF materiel management activities. Operational cycles are irregular and military risks associated with stock out positions have no commercial parallel. The AFWCF holds materiel based on military need and support for contingencies. The DoD 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 which is valued at standard purchase price. The AFWCF uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored 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, AFWCF uses the purchase method. Under this method, materials and supplies are expensed when purchased. During FY 2007, AFWCF 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 DoD 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 AFWCF 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 AFWCF 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 completeness and existence of reported values of inventory. Inventory available and purchased for resale includes consumable items and reparable parts owned and managed by AFWCF. 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 AFWCF often relies on weapon systems and machinery that are no longer in production. As a result, AFWCF supports a process that encourages the repair and rebuilding of certain items. This repair cycle is essential in 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 materiel ordered, but not delivered. Work in process includes munitions in production and depot maintenance work with its associated labor, applied overhead, and supplies used in the delivery of maintenance services.

### **1.N. Investments**

Not Applicable

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

In FY 2006, DoD 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. The AFWCF has not 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 DoD capitalization threshold of \$100 thousand. The DoD also requires capitalization of improvement costs over the DoD capitalization threshold of \$100 thousand for General PP&E. The DoD 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 the General Fund financial statements in FY 1998. No adjustment was made for WCF assets that remain capitalized and reported on WCF financial statements.

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

The DoD 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, AFWCF reports only government property in the possession of contractors that is maintained in AFWCF's property systems. The DoD has issued new property accountability and reporting requirements that require AFWCF to maintain, in their property systems, information on all property furnished to contractors. This action and other DoD proposed actions are structured to capture and report the information necessary for compliance with federal accounting standards.

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

The AFWCF'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 DoD's policy is to expense and/or properly classify assets when the related goods and services are received. The AFWCF complies with this policy.

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

Not Applicable

### **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 AFWCF's Balance Sheet.

The AFWCF conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, AFWCF 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 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 Acquisition 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 AFWCF 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 AFWCF’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.

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

The AFWCF reports as a liability 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 that 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 that were not reimbursed.

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

Not Applicable

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

Not Applicable

### **1.X. Unexpended Obligations**

The AFWCF 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 monthly 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 DoD 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 4<sup>th</sup> Quarter, FY 2007, DoD began presenting the Statement of Financing (SOF) as a note in accordance with OMB Circular A-136. The SOF will no longer be considered a basic statement and is now referred to as “Reconciliation of Net Cost of Operations to Budget.”

## Note 2. Nonentity Assets

As of September 30	2007	2006
(amounts in thousands)		
<b>1. Intragovernmental Assets</b>		
A. Fund Balance with Treasury	\$ 0	\$ 0
B. Accounts Receivable	0	0
C. Total Intragovernmental Assets	\$ 0	\$ 0
<b>2. Nonfederal Assets</b>		
A. Cash and Other Monetary Assets	\$ 0	\$ 0
B. Accounts Receivable	0	0
C. Other Assets	\$ 0	\$ 0
D. Total Nonfederal Assets	\$ 0	\$ 0
<b>3. Total Nonentity Assets</b>	\$ 0	\$ 0
<b>4. Total Entity Assets</b>	\$ 37,664,797	\$ 38,256,765
<b>5. Total Assets</b>	<b>\$ 37,664,797</b>	<b>\$ 38,256,765</b>

Asset accounts are categorized as either entity or nonentity. Entity accounts consist of resources that are available for use in the operations of the entity. The AFWCF is authorized to decide how to use resources in entity accounts. The AFWCF may be legally obligated to use these resources to meet entity obligations. Nonentity assets are assets for which the entity maintains stewardship accountability and responsibility to report, but are not available for the entity’s operations.

The AFWCF has no Nonentity Assets.

### Note 3. Fund Balance with Treasury

As of September 30	2007	2006
(amounts in thousands)		
<b>1. Fund Balances</b>		
A. Appropriated Funds	\$ 0	\$ 0
B. Revolving Funds	1,287,399	1,357,976
C. Trust Funds	0	0
D. Special Funds	0	0
E. Other Fund Types	0	0
F. Total Fund Balances	\$ 1,287,399	\$ 1,357,976
<b>2. Fund Balances Per Treasury Versus Agency</b>		
A. Fund Balance per Treasury	\$ 1,705,484	\$ 1,380,931
B. Fund Balance per AFWCF	1,287,399	1,357,976
<b>3. Reconciling Amount</b>	\$ 418,085	\$ 22,955

The reconciling amount represents \$418.1 million for the United States Transportation Command (USTC), which is reported by the U.S. Treasury as part of the AFWCF. However, for the purposes of Audited Financial Statements (AFS), USTC is included with the Other Defense Organizations reporting which is separate from the AFWCF. Therefore, USTC cash is not included on the AFWCF AFS.

### Status of Fund Balance with Treasury

As of September 30	2007	2006
(amounts in thousands)		
<b>1. Unobligated Balance</b>		
A. Available	\$ 1,073,782	\$ 925,139
B. Unavailable	0	0
<b>2. Obligated Balance not yet Disbursed</b>	8,883,865	8,603,843
<b>3. Nonbudgetary FBWT</b>	0	0
<b>4. NonFBWT Budgetary Accounts</b>	-8,670,248	-8,171,006
<b>5. Total</b>	\$ 1,287,399	\$ 1,357,976

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. There are no restrictions on the Unobligated Balance.

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 do not have budgetary authority, such as unavailable receipt accounts or clearing accounts.

NonFBWT Budgetary Accounts represent adjustments to budgetary accounts that do not affect FBWT such as contract authority, borrowing authority and investment accounts, accounts receivable, as well as the unfilled orders without advance from customers. This category reduces the Status of FBWT.

## Disclosures Related to Suspense/Budget Clearing Accounts

The AFWCF has no Disclosures Related to Suspense/Budget Clearing Accounts.

## Disclosures Related to Problem Disbursements

As of September 30	2005	2006	2007	(Decrease)/Increase from FY 2006 - 2007
(amounts in thousands)				
<b>1. Total Problem Disbursements, Absolute Value</b>				
A. Unmatched Disbursements (UMDs)	\$ 60,443	\$ 8,377	\$ 12,624	\$ 4,247
B. Negative Unliquidated Obligations (NULO)	2,405	717	971	254
C. In-Transit Disbursements	432,917	205,614	173,842	-31,772
<b>2. Total</b>	<b>\$ 495,765</b>	<b>\$ 214,708</b>	<b>\$ 187,437</b>	<b>\$ -27,271</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-Transit Disbursements represent the absolute value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity and have not been posted to the accounting system.

Beginning with 2<sup>nd</sup> Quarter, FY 2007, In-Transit Disbursements are reported as an absolute value as opposed to net amounts disclosed in prior years. This reporting change applies to amounts in the note schedule for both the current and comparative years.

## Note 4. Investments and Related Interest

The AFWCF has no Investments and Related Interest.

## Note 5. Accounts Receivable

As of September 30	2007			2006
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable	Accounts Receivable, Net
(amounts in thousands)				
<b>1. Intragovernmental Receivables</b>	\$ 330,378	N/A	\$ 330,378	\$ 420,073
<b>2. Nonfederal Receivables (From the Public)</b>	117,808	\$ 0	117,808	232,314
<b>3. Total Accounts Receivable</b>	<b>\$ 448,186</b>	<b>\$ 0</b>	<b>\$ 448,186</b>	<b>\$ 652,387</b>

The AFWCF policy is all NonFederal Receivables (From the Public) will be collected resulting in the Allowance for Estimated Uncollectibles being reported as a \$0.0 balance.

## Aged Accounts Receivable

As of September 30	2007		2006	
	Intragovernmental	Nonfederal	Intragovernmental	Nonfederal
(amounts in thousands)				
<b>Nondelinquent</b>				
Current	\$ 495,044	\$ 113,230	\$ 727,179	\$ 220,312
Noncurrent	0	0	0	0
<b>Delinquent</b>				
1 to 30 days	\$ 190	\$ 293	\$ 624	436
31 to 60 days	274	15	2,353	264
61 to 90 days	14	88	2,323	936
91 to 180 days	140	105	-521	718
181 days to 1 year	508	1,035	129	3,656
Greater than 1 year and less than or equal to 2 years	57	2,248	1,023	5,274
Greater than 2 years and less than or equal to 6 years	0	760	13	651
Greater than 6 years and less than or equal to 10 years	0	0	0	125
Greater than 10 years	0	135	0	3
<b>Subtotal</b>	<b>\$ 496,227</b>	<b>\$ 117,909</b>	<b>\$ 733,123</b>	<b>\$ 232,375</b>
Less Supported Undistributed	0	-36	-467	0
Less Eliminations	-165,914	0	-312,643	0
Less Other	65	-65	60	-61
<b>Total</b>	<b>\$ 330,378</b>	<b>\$ 117,808</b>	<b>\$ 420,073</b>	<b>\$ 232,314</b>

Delinquent Nonfederal receivables over 60 days old are referred to the Debt Management Office (DMO) at Columbus and those exceeding 180 days are referred to the U.S. Treasury or the Department of Justice (DOJ) by Columbus for collection action, as appropriate. Collection actions involving amounts of \$600 or more will appropriately be transferred to DMO after a 60 day delinquency. Debt returned uncollectible from U.S. Treasury of \$500 thousand or more is referred to DOJ. Debt returned less than \$100 thousand, may be written



off by DMO after coordination with AFWCF management. The Defense Finance and Accounting Service Denver and AFWCF management follow up on a monthly basis to confirm the status of the delinquent account receivables referred to the above agencies.

Delinquent Intragovernmental receivables not paid within 30 days are disputed in accordance with the procedures outlined in the Intra-governmental Business Rules published in the Treasury Financial Management guidance.

In the 4<sup>th</sup> Quarter, FY 2006, 91 to 180 days Intragovernmental category, \$521.0 thousand is an abnormal balance due to a posting error. The posting error was corrected 1<sup>st</sup> Quarter, FY 2007.

The Other line for 4<sup>th</sup> Quarter, FY 2007 represents the correction of posting errors resulting in a reclassification of Nonfederal to Intra-governmental receivables.

The Other line for 4<sup>th</sup> Quarter, FY 2006 represents the correction of posting errors resulting in a reclassification of Nonfederal to Intra-governmental receivables

## Note 6. Other Assets

As of September 30	2007		2006	
(amounts in thousands)				
<b>1. Intragovernmental Other Assets</b>				
A. Advances and Prepayments	\$	1,248	\$	5,218
B. Other Assets		0		0
C. Total Intragovernmental Other Assets	\$	1,248	\$	5,218
<b>2. Nonfederal Other Assets</b>				
A. Outstanding Contract Financing Payments	\$	153,834	\$	177,481
B. Other Assets (With the Public)		165,628		363,662
C. Total Nonfederal Other Assets	\$	319,462	\$	541,143
<b>3. Total Other Assets</b>	<b>\$</b>	<b>320,710</b>	<b>\$</b>	<b>546,361</b>

Contract terms and conditions for certain types of contract financing payments convey certain rights to the AFWCF 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 AFWCF is not obligated to make payment to the contractor until delivery and acceptance.

The Outstanding Contract Financing Payments balance of \$153.8 million is comprised of \$131.3 million in contract financing payments and an additional \$22.5 million in estimated future funded payments that will be paid to the contractor upon future delivery and Government acceptance of a satisfactory product. (See additional discussion in Note 15, Other Liabilities).

## Information Related Nonfederal Other Assets – Other Assets (With the Public)

Types of Asset (amounts in millions)	2007
<b>Advances -</b>	
SMAG - Advances and Prepayments For In-transit Inventory Items	\$ 13.1
<b>Total Advances</b>	<b>13.1</b>
<b>Other Assets -</b>	
SMAG - Other assets returns to vendors pending credit	151.2
DMAG - Unallocated labor and materials	1.3
<b>Total Other Assets</b>	<b>152.5</b>
<b>Total Non-Federal Other Assets</b>	<b>\$ 165.6</b>

### Note 7. Cash and Other Monetary Assets

The AFWCF has no Cash or Other Monetary Assets.

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

The AFWCF has no Direct Loan and/or Loan Guarantee Programs.

### Note 9. Inventory and Related Property

As of September 30	2007	2006
(amounts in thousands)		
1. Inventory, Net	\$ 34,273,552	\$ 34,170,548
2. Operating Materials & Supplies, Net	243,880	360,328
3. Stockpile Materials, Net	0	0
<b>4. Total</b>	<b>\$ 34,517,432</b>	<b>\$ 34,530,876</b>



## Inventory, Net

As of September 30	2007			2006	Valuation Method
	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Inventory, Net	
(amounts in thousands)					
<b>1. Inventory, Categories</b>					
A. Available and Purchased for Resale	\$ 23,852,074	\$ 9,104	\$ 23,861,178	\$ 23,963,306	LAC/MAC
B. Held for Repair	14,398,613	-4,198,978	10,199,635	9,908,297	LAC/MAC
C. Excess, Obsolete, and Unserviceable	776,025	-776,025	0	0	NRV
D. Raw Materials	0	0	0	0	MAC,SP,LAC
E. Work in Process	212,739	0	212,739	298,945	AC
<b>F. Total</b>	<b>\$ 39,239,451</b>	<b>\$ -4,965,899</b>	<b>\$ 34,273,552</b>	<b>\$ 34,170,548</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

## General Composition of Inventory

Inventory includes weapon system consumable and reparable parts, base supply items, and Medical-Dental supplies. Inventory is tangible personal property that is held for sale or held for repair for 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 services for a fee.

## Restrictions

There are no restrictions on the use, sale, or disposition of inventory except for War Reserve Materiel.

## Definitions

Inventory Available and Purchased for Resale includes consumable and reparable parts owned and managed by AFWCF.

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

Excess, Obsolete, and Unserviceable inventory consists of scrap materials or items that cannot be economically repaired and are awaiting disposal.

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

## Operating Materiels and Supplies, Net

As of September 30	2007			2006	Valuation Method
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	
(amounts in thousands)					
<b>1. OM&amp;S Categories</b>					
A. Held for Use	\$ 243,880	\$ 0	\$ 243,880	\$ 360,328	LAC/MAC
B. Held for Repair	0	0	0	0	LAC/MAC
C. Excess, Obsolete, and Unserviceable	0	0	0	0	NRV
<b>D. Total</b>	<b>\$ 243,880</b>	<b>\$ 0</b>	<b>\$ 243,880</b>	<b>\$ 360,328</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

## General Composition of Operating Materiels and Supplies

Operating Materiel and Supplies (OM&S) includes consumable supplies used to remanufacture spare parts and weapons systems.

### Restrictions

There are no restrictions on the use, sale, or disposition of OM&S.

### Definition

Held for Use is consumable supplies owned and managed by AFWCF.

## Stockpile Materiels, Net

The AFWCF has no Stockpile Materiels.



## Note 10. General PP&E, Net

As of September 30	2007					2006
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
(amounts in thousands)						
<b>1. Major Asset Classes</b>						
A. Land	N/A	N/A	\$ 0	N/A	\$ 0	\$ 0
B. Buildings, Structures, and Facilities	S/L	20 Or 40	908,071	\$ -653,403	254,668	318,730
C. Leasehold Improvements	S/L	lease term	0	0	0	0
D. Software	S/L	2-5 Or 10	1,068,779	-780,156	288,623	305,282
E. General Equipment	S/L	5 or 10	2,032,123	-1,535,569	496,554	502,354
F. Military Equipment	S/L	Various	0	0	0	0
G. Assets Under Capital Lease	S/L	lease term	0	0	0	0
H. Construction-in- Progress	N/A	N/A	51,225	N/A	51,225	42,799
I. Other			0	0	0	0
<b>J. Total General PP&amp;E</b>			<b>\$ 4,060,198</b>	<b>\$ -2,969,128</b>	<b>\$ 1,091,070</b>	<b>\$ 1,169,165</b>

### Note 15 for additional information on Capital Leases

#### Legend for Valuation Methods:

S/L = Straight N/A = Not Applicable

Real property reported by the Automated Civil Engineering System (ACES) and equipment reported by the Air Force Equipment Management System and Information Processing Management System have not been validated and reconciled. Past audit results have identified uncertainties as to whether all General PP&E assets in the possession or control (existence) of the AFWCF are properly and accurately recorded in the system (completeness). The Air Logistic Centers (ALC) and Aerospace Maintenance and Regeneration Group (AMARG) use ACES to capture the costs of real property based on preponderance of use for each building. The ALC and AMARG use the straight line method for recording depreciation maintained on spreadsheets in place of the ACES schedule. The accounting entries are recorded directly into the field level trial balances.

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

The AFWCF has no General PP&E located Outside of the Continental/Contiguous United States.

### Assets Under Capital Lease

The AFWCF has no Assets Under Capital Lease.

## Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2007	2006
(amounts in thousands)		
<b>1. Intragovernmental Liabilities</b>		
A. Accounts Payable	\$ 0	\$ 0
B. Debt	0	0
C. Other	0	0
<b>D. Total Intragovernmental Liabilities</b>	<b>\$ 0</b>	<b>\$ 0</b>
<b>2. Nonfederal Liabilities</b>		
A. Accounts Payable	\$ 0	\$ 0
B. Military Retirement and Other Federal Employment Benefits	228,900	227,035
C. Environmental Liabilities	0	0
D. Other Liabilities	28,376	0
<b>E. Total Nonfederal Liabilities</b>	<b>\$ 257,276</b>	<b>\$ 227,035</b>
<b>3. Total Liabilities Not Covered by Budgetary Resources</b>	<b>\$ 257,276</b>	<b>\$ 227,035</b>
<b>4. Total Liabilities Covered by Budgetary Resources</b>	<b>\$ 1,886,092</b>	<b>\$ 2,037,616</b>
<b>5. Total Liabilities</b>	<b>\$ 2,143,368</b>	<b>\$ 2,264,651</b>

Liabilities not covered by budgetary resources are liabilities for which Congressional action is needed before budgetary resources can be provided.

Military Retirement and Other Federal Employment Benefits represent the Actuarial Federal Employee Compensation future liabilities as provided by the Department of Labor.

Military Retirement and Other Federal Employment Benefits not covered by budgetary resources are comprised of \$228.9 million for Federal Employee's Compensation Act actuarial liabilities not due and payable during the current fiscal year. Refer to Note 17, Military Retirement and Other Federal Employment Benefits, for additional details and disclosures.

Nonfederal Other Liabilities includes \$28.4 million in foreign government deposits. These deposits represent future purchases that various foreign military customers plan to make from the Supply Management Activity Group. These advanced funds held for future purchases are a liability and are returned if the countries do not make future purchases. Revenue is not recognized on these transactions until the purchase takes place. The U.S. Treasury directed the policy change which was implemented on 2<sup>nd</sup> Quarter, FY 2007.



## Note 12. Accounts Payable

As of September 30	2007			2006
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
(amounts in thousands)				
1. Intragovernmental Payables	\$ 117,965	N/A	\$ 117,965	\$ 171,623
2. Nonfederal Payables (to the Public)	946,756	0	946,756	494,347
<b>3. Total</b>	<b>\$ 1,064,721</b>	<b>\$ 0</b>	<b>\$ 1,064,721</b>	<b>\$ 665,970</b>

The AFWCF's systems do not track intragovernmental transactions by customer at the transaction level. Therefore, internal DoD buyer-side balances are adjusted to agree with internal seller-side balances for revenue, accounts receivable, and unearned revenue. Accounts payable are adjusted by reclassifying amounts between federal and nonfederal accounts payable.

## Note 13. Debt

The AFWCF has no Debt.

## Note 14. Environmental Liabilities and Disposal Liabilities

The AFWCF has no Environmental Liabilities and Disposal Liabilities.

## Note 15. Other Liabilities

As of September 30	2007			2006
	Current Liability	Noncurrent Liability	Total	Total
(amounts in thousands)				
<b>1. Intragovernmental</b>				
A. Advances from Others	\$ 124,243	\$ 0	\$ 124,243	\$ 163,617
B. Deposit Funds and Suspense Account Liabilities	0	0	0	0
C. Disbursing Officer Cash	0	0	0	0
D. Judgment Fund Liabilities	0	0	0	0
E. FECA Reimbursement to the Department of Labor	0	0	0	0
F. Other Liabilities	10,793	0	10,793	10,599
G. Total Intragovernmental Other Liabilities	\$ 135,793	\$ 0	\$ 135,036	\$ 174,216
<b>2. Nonfederal</b>				
A. Accrued Funded Payroll and Benefits	\$ 141,206	\$ 0	\$ 141,206	\$ 147,711
B. Advances from Others	26,115	0	26,115	5,215
C. Deferred Credits	0	0	0	0
D. Deposit Funds and Suspense Accounts	0	0	0	806
E. Temporary Early Retirement Authority	0	0	0	0
F. Nonenvironmental Disposal Liabilities	0	0	0	0
(1) Military Equipment (Nonnuclear)	0	0	0	0
(2) Excess/Obsolete Structures	0	0	0	0
(3) Conventional Munitions Disposal	0	0	0	0
G. Accrued Unfunded Annual Leave	0	0	0	0
H. Capital Lease Liability	0	0	0	0
I. Other Liabilities	524,890	22,500	547,390	1,043,698
J. Total Nonfederal Other Liabilities	\$ 692,211	\$ 22,500	\$ 714,711	\$ 1,197,430
<b>3. Total Other Liabilities</b>	<b>\$ 827,247</b>	<b>\$ 22,500</b>	<b>\$ 849,747</b>	<b>\$ 1,371,646</b>

## Information Related to Intragovernmental Other Liabilities

As of September 30 (amounts in thousands)	FY 2007
DMAG Health Benefits	\$ 4,774
DMAG Life Insurance	92
DMAG Retirement	4,824
SMAG Health Benefits	488
SMAG Life Insurance	12
SMAG Retirement	603
<b>Total</b>	<b>\$ 10,793</b>



## Information Related to Nonfederal Other Liabilities

As of September (amounts in thousands)	FY 2007
Contract DMAG WIP Material and Labor	\$ 456,500
DMAG Contract Withholds	5,635
SMAG Future Purchase - Foreign Military Sales	28,377
SMAG Contract Withholds	34,378
Contingent Liabilities Contract Financing Payments	22,500
<b>Total</b>	<b>\$ 10,793</b>

Contingent liabilities balance includes \$22.5 million in estimated future contract financing payments that will be paid to the contractor 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 payments is made. This action protects taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as the rights of ownership. The AFWCF 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 AFWCF and the amount of potential future payment is estimable; the AFWCF has recognized a contingent liability for estimated future payments, which are conditional pending delivery and Government acceptance.

### Note 16. Commitments and Contingencies

The AFWCF is not aware of any Commitments and Contingencies for legal liability except for the \$22.5 million contract financing payments reported in Note 15.

The AFWCF is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolution, that may or may not result in a future outflow of expenditures. Currently, AFWCF does not have a systemic process by which it captures or assesses these potential contingent liabilities; therefore, the amounts reported may not fairly present AFWCF's contingent liabilities.

## Note 17. Military Retirement and Other Federal Employment Benefits

As of September 30	2007			2006
	Present Value of Benefits	Assumed Interest Rate (%)	Unfunded Liability	Present Value of Benefits
(amounts in thousands)				
<b>1. Pension and Health Actuarial Benefits</b>	\$ 0	\$ 0	\$ 0	\$ 0
A. Military Retirement Pensions	0	0	0	0
B. Military Retirement Health Benefits	0	0	0	0
C. Military Medicare-Eligible Retiree Benefits	0	0	0	0
<b>D. Total Pension and Health Actuarial Benefits</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>
<b>2. Other Actuarial Benefits</b>	0	0	0	0
A. FECA	\$ 228,900	\$ 0	\$ 228,900	\$ 227,035
B. Voluntary Separation Incentive Programs	0	0	0	0
C. DoD Education Benefits Fund	0	0	0	0
<b>D. Total Other Actuarial Benefits</b>	<b>\$ 228,900</b>	<b>\$ 0</b>	<b>\$ 228,900</b>	<b>\$ 227,035</b>
<b>3. Other Federal Employment Benefits</b>	\$ 0	\$ 0	\$ 0	\$ 0
<b>4. Total Military Retirement and Other Federal Employment Benefits</b>	<b>\$ 228,900</b>	<b>\$ 0</b>	<b>\$ 228,900</b>	<b>\$ 227,035</b>

### Federal Employees Compensation Act (FECA)

The AFWCF actuarial liability for workers' compensation benefits is developed by the Department of Labor and is updated at the end of each fiscal year. The liability includes the estimated liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments. The projected annual benefit payments are discounted to present value using the Office of Management and Budget's (OMB's) economic assumptions for 10-year Treasury notes and bonds. Cost of living adjustments (COLAs) and consumer price index medical (CPIM) factors are applied to the calculation of projected future benefits.

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

#### 2006

5.170% in Year 1

5.313% 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 (COLAs) and medical inflation factors (CPIMs) were applied to the calculation of projected future benefits. The actual rates for these factors for the charge back year (CBY) 2006 are used to adjust the methodology's historical payments to current year constant dollars.



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

	2006	2007	2008	2009	2010 +
<b>COLA</b>	3.50%	3.13%	2.40%	2.40%	2.43%
<b>CPIM</b>	4.00%	4.01%	4.01%	4.013%	4.09%

The model's resulting projections were analyzed to insure that the estimates were reliable. The analysis was based on four tests: (1) a sensitivity 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 2006 to the average pattern observed during the most current three charge back years, and (4) a comparison of the estimated liability per case in the 2006 projection to the average pattern for the projections of the most recent three years.

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

### Intragovernmental Costs and Exchange Revenue

As of September 30	2007		2006	
(amounts in thousands)				
1. Intragovernmental Costs	\$	3,956,343	\$	4,748,892
2. Public Costs		6,778,788		3,923,068
3. Total costs	\$	10,735,131	\$	8,671,960
4. Intragovernmental Earned Revenue	\$	-9,697,266	\$	-10,105,650
5. Public Earned Revenue		-734,496		-677,373
<b>6. Total Earned Revenue</b>	\$	-10,431,762	\$	-10,783,023
<b>7. Net Cost of Operations</b>	\$	<b>303,369</b>	\$	<b>-2,111,063</b>

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.

The AFWCF's systems do not track intergovernmental transactions by customer at the transaction level. Therefore, internal DoD buyer-side balances are adjusted to agree with seller-side balances for revenue. Expenses are adjusted by reclassifying amounts between federal and nonfederal expenses.

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.

The AFWCF records transactions on an accrual basis. The AFWCF may not have all the actual costs and revenues input into the system in time for reporting. Accrual estimates based upon budget information, historical data, and current data not yet input are made as required by generally accepted accounting principles. These estimates are reversed in order to allow actual cost and revenue data to populate the general ledger in subsequent months.

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

As of September 30	2007		2006	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
(amounts in thousands)				
<b>1. Prior Period Adjustments Increases (Decreases) to Net Positions Beginning Balance</b>				
A. Changes in Accounting Standards	\$ 0	\$ 0	\$ 0	\$ 0
B. Errors and Omissions in Prior Year Accounting Reports	0	0	0	0
<b>C. Total Prior Period Adjustments</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>
<b>2. Imputed Financing</b>				
A. Civilian CSRS/FERS Retirement	\$ 50,951	\$ 0	\$ 55,234	\$ 0
B. Civilian Health	117,383	0	109,111	0
C. Civilian Life Insurance	276	0	264	0
D. Judgment Fund	0	0	0	0
E. IntraEntity	0	0	0	0
<b>F. Total Imputed Financing</b>	<b>\$ 168,610</b>	<b>\$ 0</b>	<b>\$ 164,609</b>	<b>\$ 0</b>

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

## Note 20. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2007	2006
(amounts in thousands)		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	\$ 7,196,353	\$ 7,151,764
2. Available Borrowing and Contract Authority at the End of the Period	\$ 0	\$ 4,183,095

The Statement of Budgetary Resources (SBR) includes intraentity transactions because the statements are presented as combined and combining.

This note has been modified to accurately report the remaining available balance of borrowing and contract authority. Previously, the AFWCF reported the amount of the contract/borrowing authority that had initially been used and not subsequently replaced by reimbursement or appropriation.

Office of Management and Budget Circular A-136 requires disclosure of the amount of direct and reimbursable obligations incurred against amounts apportioned under categories A, B, and exempt from apportionment. This disclosure should agree with the aggregate of the related information as included in each reporting entity's SF 133 and in the SBR, lines 8A and 8B. There are no Category A direct obligations. Category B reimbursable obligations total \$14.1 billion. There are no category B direct or exempt obligations.



## Note 21. Reconciliation of Net Cost of Operations to Budget

As of September 30	2007	2006
(amounts in thousands)		
<b>Resources Used to Finance Activities:</b>		
Budgetary Resources Obligated:		
1. Obligations incurred	\$ 14,102,303	\$ 15,773,214
2. Less: Spending authority from offsetting collections and recoveries (-)	-13,946,800	-15,063,364
3. Obligations net of offsetting collections and recoveries	\$ 155,503	\$ 709,850
4. Less: Offsetting receipts (-)	0	0
5. Net obligations	\$ 155,503	\$ 709,850
<b>Other Resources:</b>		
6. Donations and forfeitures of property	0	0
7. Transfers in/out without reimbursement (+/-)	2,192	0
8. Imputed financing from costs absorbed by others	168,610	164,609
9. Other (+/-)	0	0
10. Net other resources used to finance activities	\$ 170,802	\$ 164,609
11. Total resources used to finance activities	326,305	874,459
<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:		
A. Undelivered Orders (-)	\$ -44,589	\$ -214,214
B. Unfilled Customer Orders	190,395	-925,904
13. Resources that fund expenses recognized in prior Periods (-)	0	-7,923
14. Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	0	0
15. Resources that finance the acquisition of assets (-)	-5,376,572	-4,988,458
16. Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations:		
A. Less: Trust or Special Fund Receipts Related to exchange in the Entity's Budget (-)	0	0
B. Other (+/-)	-2,192	0
17. Total resources used to finance items not part of the Net Cost of Operations	\$ -5,232,958	\$ -6,136,499
18. Total resources used to finance the Net Cost of Operations	\$ -4,906,653	\$ -5,262,040
<b>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:</b>		
<b>Components Requiring or Generating Resources in Future Period:</b>		
19. Increase in annual leave liability	\$ 0	\$ 0
20. Increase in environmental and disposal liability	0	0
21. Upward/Downward reestimates of credit subsidy expense (+/-)	0	0
22. Increase in exchange revenue receivable from the public (-)	0	6
23. Other (+/-)	30,241	1,244
24. Total components of Net Cost of Operations that will Require or Generate Resources in future periods	\$ 30,241	\$ 1,250
Components not Requiring or Generating Resources:	\$ 142,937	\$ 166,193
25. Depreciation and amortization		
26. Revaluation of assets or liabilities (+/-)	1,893,247	849,401
27. Other (+/-)		
A. Trust Fund Exchange Revenue	0	0
B. Cost of Goods Sold	5,331,747	5,130,847
C. Operating Material and Supplies Used	0	0
D. Other	-2,188,150	-2,996,714
28. Total Components of Net Cost of Operations that will not Require or Generate Resources	\$ 5,179,781	\$ 3,149,727
29. Total components of Net Cost of Operations that will not Require or Generate Resources in the current period	\$ 5,210,022	\$ 3,150,977
<b>30. Net Cost of Operations</b>	<b>\$ 303,369</b>	<b>\$ -2,111,063</b>

Due to the AFWCF'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.

Resources that finance the acquisition of assets are adjusted in order to align the note schedule with the amount reported on the Statement of Net Cost. This adjustment is \$233.0 million, absolute value.

The following schedule 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

Resources Used to Finance Items Not Part of Net Cost of Operations, Other line is comprised of \$2.2 million excess data processing equipment transfer from Air Force General Fund to AFWCF Depot Maintenance Activity Group (DMAG).

Components Requiring or Generating Resources in Future Periods, Other line is comprised of \$28.4 million for foreign government deposits and \$1.8 million in Federal Employees Compensation Act (FECA).

Components Not Requiring or Generating Resources, Other line is comprised of Supply Management Activity Group materials to replace condemned and consumable parts required for depot production of \$2.9 billion and DMAG completed production projects returned to customers of (\$5.1) billion.

Components of the Net Cost of Operation that will Require or Generate Resources in Future Periods is in balance with the Total Liabilities Not Covered by Budgetary Resources.

## **Note 22. Disclosures Related to Incidental Custodial Collections**

The AFWCF has no Disclosures Related to Incidental Custodial Collections.

## **Note 23. Earmarked Funds**

The AFWCF has no Earmarked Funds.

## **Note 24. Other Disclosures**

The AFWCF has no Other Disclosures.

## **Note 25. Restatements**

The AFWCF has no Restatements of prior period adjustments for material errors.





# Working Capital Fund

Fiscal Year 2007

Required Supplementary Information



## Statement of Disaggregated Budgetary Resources - Working Capital Fund

As of September 30, 2007 and 2006 (amounts in thousands)

	<u>Working Capital Fund</u>	<u>2007 Combined</u>	<u>2006 Combined</u>
<b>BUDGETARY FINANCING ACCOUNTS</b>			
<b>BUDGETARY RESOURCES:</b>			
1. Unobligated balance, brought forward, October 1	\$ 925,138	\$ 925,137	\$ 292,678
2. Recoveries of prior year unpaid obligations	23,359	23,358	79,238
3. Budget authority			
A. Appropriation	44,054	44,054	48,577
B. Borrowing authority	0	0	0
C. Contract authority	9,804,576	9,804,575	9,857,832
D. Spending authority from offsetting collections			
1. Earned			
a. Earned	14,106,629	14,106,630	15,953,188
b. Change in receivables from Federal sources	-373,583	-373,583	-43,158
2. Change in unfilled customer orders			
a. Advance received	-40,165	-40,165	10,419
b. Without advance from Federal sources	230,560	230,560	-936,323
3. Anticipated for rest of year, without advances	0	0	0
4. Previously unavailable	0	0	0
5. Expenditure transfers from trust funds	0	0	0
E. Subtotal	\$ 23,772,071	\$ 23,772,071	\$ 24,890,535
4. Nonexpenditure transfers, net, anticipated and actual	-382,000	-382,000	-106,784
5. Temporarily not available pursuant to Public Law	0	0	0
6. Permanently not available	-9,162,482	-9,162,481	-8,457,316
<b>7. Total Budgetary Resources</b>	<u>15,176,086</u>	<u>15,176,086</u>	<u>16,698,351</u>
<b>STATUS OF BUDGETARY RESOURCES:</b>			
8. Obligations incurred			
A. direct	\$ 0	\$ 0	\$ 0
B. Reimbursable	14,102,303	14,102,303	15,773,214
C. Subtotal	<u>14,102,303</u>	<u>14,102,303</u>	<u>15,773,214</u>
9. Unobligated balance			
A. Apportioned	1,073,782	1,073,782	925,137
B. Exempt from apportionment	0	0	0
C. Subtotal	<u>1,073,782</u>	<u>1,073,782</u>	<u>925,137</u>
10. Unobligated balance not available	0	0	0
<b>11. Total status of budgetary resources</b>	<u>\$ 15,176,085</u>	<u>\$ 15,176,085</u>	<u>\$ 16,698,351</u>
<b>CHANGE IN OBLIGATED BALANCE:</b>			
12. Obligated balance, net			
A. Unpaid obligations, brought forward, October 1	\$ 8,603,843	\$ 8,603,843	\$ 8,621,328
B. Less: Uncollected customer payments from Federal sources, brought forward, October 1	-3,987,910	-3,987,910	-4,967,392
C. Total unpaid obligated balance	<u>4,615,933</u>	<u>4,615,933</u>	<u>3,653,936</u>
13. Obligations incurred net (+/-)	\$ 14,102,303	\$ 14,102,303	\$ 15,773,214
14. Less: Gross outlays	-13,798,923	-13,798,923	-15,711,459
15. Obligated			
A. Actual transfers, unpaid obligations (+/-)	0	0	0
B. Actual transfers, uncollected customer payments from Federal sources (+/-)	0	0	0
C. Total Unpaid obligated balance transferred, net	<u>0</u>	<u>0</u>	<u>0</u>
16. Less: Recoveries of prior year unpaid obligations, actual	\$ -23,359	\$ -23,359	\$ -79,238
17. Change in uncollected customer payments from Federal sources (+/-)	143,023	143,023	979,482
18. Obligated balance, net, end of period			
A. Unpaid obligations	8,883,865	8,883,865	8,603,843
B. Less: Uncollected customer payments	-3,884,887	-3,884,887	-3,987,910
C. Total, unpaid obligated balance, net, end of period	<u>5,038,978</u>	<u>5,038,978</u>	<u>4,615,933</u>
<b>NET OUTLAYS:</b>			
<b>19. Net Outlays</b>			
A. Gross outlays	\$ 13,798,923	\$ 13,798,923	\$ 15,711,459
B. Less: Offsetting collections	-14,066,464	-14,066,465	-15,963,606
C. Less: Distributed Offsetting receipts	0	0	0
<b>20. Net Outlays</b>	<u>\$ -267,541</u>	<u>\$ -267,542</u>	<u>\$ -252,147</u>

## DISAGGREGATED STATEMENT OF BUDGETARY RESOURCES

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

Required Supplementary Information - Part A AT97 - Air Force Working Capital Fund Schedule, Part A DoD Intragovernmental Asset Balances. (amounts in thousands)	Treasury Index	Fund Balance with Treasury	Accounts Receivable	Loans Receivable	Investments	Other
Department of Agriculture	12		\$ 63			
Department of Justice	15		206			
Navy General Fund	17		4,701			
Department of State	19		12			
Department of the Treasury	20	\$ 1,287,399	2			
Army General Fund	21		217			
General Service Administration	47		2,279			
National Science Foundation	49		96			
Air Force General Fund	57		252,228			\$ 418
Department of Transportation	69		-519			
Homeland Security	70		1,781			
National Aeronautics and Space Administration	80		664			
Other Defense Organizations General Funds	97		39,289			
Other Defense Organizations Working Capital Funds	97-4930		22,812			829
Army Working Capital Fund	97-4930.001		1,657			
Navy Working Capital Fund	97-4930.002		4,892			
<b>Totals</b>		<b>\$ 1,287,399</b>	<b>\$ 330,380</b>			<b>\$ 1,247</b>

Required Supplementary Information - Part A AT97 - Air Force Working Capital Fund Schedule, Part A DoD Intragovernmental Asset Balances. (amounts in thousands)	Treasury Index	Accounts Payable	Debts/Borrowings From Other Agencies	Other
Navy General Fund	17	\$ 310		
Army General Fund	21	670		\$ 202
Office of Personnel Management	24			10,793
Air Force General Fund	57	42,647		120,321
Homeland Security	70			1,755
Other Defense Organizations General Funds	97	455		
Other Defense Organizations Working Capital Funds	97-4930	58,942		1,965
Army Working Capital Fund	97-4930.001	12,921		
Navy Working Capital Fund	97-4930.002	2,021		
<b>Totals</b>		<b>\$ 117,966</b>		<b>\$ 135,036</b>



**UNITED STATES AIR FORCE**  
**Working Capital Fund**  
 Required Supplementary Information

Required Supplementary Information - Part C AT97 - Air Force Working Capital Fund Schedule, Part C DoD Intragovernmental revenue and related costs. (amounts in thousands)	Treasury Index	Earned Revenue
Department of Agriculture	12	\$ 787
Department of Justice	15	4,700
Navy General Fund	17	84,564
Department of State	19	84
Army General Fund	21	26,435
General Service Administration	47	55
National Science Foundation	49	\$96
Air Force General Fund	57	7,932,537
Department of Transportation	69	74
Homeland Security	70	9,145
National Aeronautics and Space Administration	80	2,172
US Army Corps of Engineers	96	339
Other Defense Organizations General Funds	97	1,319,276
Other Defense Organizations Working Capital Funds	97-4930	242,190
Army Working Capital Fund	97-4930.001	20,289
Navy Working Capital Fund	97-4930.002	48,888
<b>Totals</b>		<b>\$ 9,691,631</b>

Required Supplementary Information - Part E AT97 - Air Force Working Capital Fund Schedule, Part E DoD Intragovernmental non-exchange revenues. (amounts in thousands)	Treasury Index	Accounts Payable	Other
Navy General Fund	17		\$ 100,000
Air Force General Fund	57	\$ 2,192	282,000
Other Defense Organizations General Funds	97		0
<b>Totals</b>		<b>\$ 2,192</b>	<b>\$ 382,000</b>



# Working Capital Fund

Fiscal Year 2007

Audit Opinion



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

November 8, 2007

MEMORANDUM FOR PRINCIPAL DEPUTY ASSISTANT SECRETARY OF THE AIR  
FORCE (FINANCIAL MANAGEMENT)

SUBJECT: Independent Auditor's Report on the Air Force FY 2007 Working Capital Fund  
Financial Statements (Report No. D-2008-011)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying Air Force Working Capital Fund Consolidated Balance Sheets as of September 30, 2007 and 2006, and the Consolidated Statements of Net Cost, the Consolidated Statements of Changes in Net Position, the Combined Statements of Budgetary Resources, and related notes for the fiscal years then ended.<sup>1</sup> The financial statements are the responsibility of Air Force management. The Air Force is also responsible for implementing effective internal control and for complying with laws and regulations. We are unable to express an opinion on the Air Force Working Capital Fund FY 2007 Financial Statements because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance with Laws and Regulations. The Report on Internal Control and Compliance with Laws and Regulations is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of our work.

**Disclaimer of Opinion on the Financial Statements**

The Principal Deputy Assistant Secretary of the Air Force (Financial Management) acknowledged to us that the Air Force Working Capital Fund FY 2007 Financial Statements would not substantially conform to accounting principles generally accepted in the United States of America (GAAP), and that DoD financial management and feeder systems were unable to adequately support material amounts on the financial statements as of September 30, 2007. Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to performing only those audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. Therefore, we did not perform auditing procedures required by U.S. Government auditing standards and Office of Management and Budget (OMB) Bulletin No. 07-04 to determine whether material amounts on the financial statements were fairly presented. Prior audits have identified, and the Air Force has also acknowledged, the long-standing material internal control weaknesses identified in the Summary of Internal Control. These pervasive material weaknesses may affect the reliability of certain information contained in the annual financial statements—much of which is taken from the same data sources as the basic financial statements.<sup>2</sup> Therefore, we are unable to express, and we do not express, an opinion on the basic financial statements. Further, the purpose of the audit was not to express an opinion on Management Discussion and Analysis, Required Supplementary Information, Other

<sup>1</sup> Beginning in FY 2007, OMB Circular A-136 requires entities to present the Statement of Financing as a note. It is no longer considered a basic statement.

<sup>2</sup> The annual financial statements include the basic statements, Management Discussion and Analysis, Required Supplementary Information, and Other Accompanying Information.

Accompanying Information, and Performance Measures accompanying the basic financial statements. Accordingly, we express no opinion on that information.

### Summary of Internal Control

In planning our work, we considered Air Force Working Capital Fund internal controls over financial reporting and compliance with applicable laws and regulations. We did this to determine our procedures for auditing the financial statements and to comply with OMB guidance, but our purpose was not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance with applicable laws and regulations. However, previously identified weaknesses, all of which are material, continued to exist in the following areas

- **Financial Management Systems**
- **In-Transit Inventory**
- **Operating Materials and Supplies**
- **Property, Plant, and Equipment**
- **Subsidiary Ledgers and Special Journals**
- **Intragovernmental Eliminations**
- **Other Accounting Entries**

A material weakness is a significant deficiency,<sup>3</sup> or a combination of significant deficiencies, resulting in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.<sup>4</sup>

Our internal control work (conducted as part of prior audits) would not necessarily disclose all Air Force Working Capital Fund significant deficiencies. The Attachment offers additional details on these significant deficiencies, all of which we consider to be material internal control weaknesses.

### Summary of Compliance with Laws and Regulations

Our work to determine compliance with selected provisions of applicable laws and regulations related to financial reporting was limited because management acknowledged that instances of noncompliance identified in prior audits continue to exist. The Principal Deputy Assistant Secretary of the Air Force (Financial Management) acknowledged to us that the Air Force financial management systems do not substantially comply with Federal financial management system requirements, GAAP, and the U.S. Government Standard General Ledger at the transaction level. Therefore, we did not determine whether the Air Force was in compliance with all applicable laws and regulations related to financial reporting. Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and,

<sup>3</sup> A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, adversely affecting the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles.

<sup>4</sup> The term "remote" is defined as "the chance of the future event or events occurring is slight." Therefore, the likelihood of an event is "more than remote" when it is at least reasonably possible.



accordingly, we do not express such an opinion. See the Attachment for additional details on compliance with laws and regulations.

### **Management's Responsibilities**

Management is responsible for:

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

We provided a draft of this report to the Principal Deputy Assistant Secretary of the Air Force (Financial Management) who then provided us technical comments, which we incorporated as appropriate. The Air Force officials expressed their continuing commitment to address the problems this report outlines.

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

Attachment:  
As stated

## Report on Internal Control and Compliance with Laws and Regulations

### Internal Control

Management is responsible for implementing and maintaining effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly; that the requirements of applicable laws and regulations are met; and that assets are safeguarded against misappropriation and abuse. Our purpose was not to, and we do not, express an opinion on internal control over financial reporting. However, we have identified the following material weaknesses and significant deficiencies that could adversely affect Air Force financial reporting.

**Previously Identified Material Weaknesses:** Management acknowledged that previously identified significant deficiencies, all of which are material, continued to exist in the following areas.

**Financial Management Systems.** Statement of Federal Financial Accounting Concepts No. 1, "Objectives of Federal Financial Reporting," requires that financial management system controls be adequate to ensure that transactions are: executed in accordance with budgetary and financial laws and other requirements; consistent with the purposes authorized; and recorded in accordance with Federal accounting standards. Statement of Federal Financial Accounting Concepts No. 1 also requires that financial management system controls ensure that assets are properly safeguarded to deter fraud, waste, and abuse, and that performance measurement information is adequately supported. The Principal Deputy Assistant Secretary of the Air Force (Financial Management) acknowledged that many Air Force financial management systems do not substantially comply with Federal financial management system requirements. Air Force financial management and feeder systems were not designed to collect and record financial information based on a full accrual accounting basis. Until these systems are updated to collect and report financial information in compliance with GAAP, Air Force financial reporting will be based on budgetary transactions and non-financial feeder systems.

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

**Operating Materials and Supplies.** The Air Force is required by Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property", to use historical cost to value its Operating Materials and Supplies inventory. However, Air Force currently values this inventory using standard costs. Statement of Federal Financial Accounting Standards No. 3 also states that Operating Materials and Supplies must be expensed when the items are consumed. Cost of goods sold and work in process are not recorded in accordance with Statement of Federal Financial Accounting Standards No. 3. In addition, uncertainties exist regarding the existence and completeness of the quantities used to derive the balances reported in the financial statements for operating materials and supplies inventory.

**General Property, Plant, and Equipment.** The Air Force is required by Statement of Federal Financial Accounting Standards No. 6, "Accounting for Property, Plant, and Equipment" to record General Property, Plant, and Equipment using acquisition cost, capitalize improvement costs, and recognize depreciation expense. However, General Property, Plant, and Equipment values cannot be verified in accordance with Statement of Federal Financial Accounting Standards No. 6. In addition, the General Property, Plant, and Equipment line item on the



Balance Sheet does not include all Government-furnished equipment (with values exceeding the capitalization threshold) in the hands of contractors.

**Subsidiary Ledgers and Special Journals.** Air Force Working Capital Fund resource managers do not always maintain adequate documentation or use transaction subsidiary ledgers and special journals to support recorded trial balance accounts. Air Force and Defense Finance and Accounting Service personnel do not perform reconciliations and system validations to verify the accuracy of accounts receivable from foreign military sales, progress payments to contractors, and accounts payable from the Materiel Support Division.

**Intragovernmental Transaction Accounting.** The Air Force cannot accurately identify all intragovernmental transactions by customer. Seller entities within DoD provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records are adjusted to recognize unrecorded costs and accounts payable.

**Other Accounting Entries.** The Air Force acknowledged that it continues to record material transactions that are not properly recorded in the accounting records supporting the financial statements or disclosed in the notes to those statements.

These financial management deficiencies may cause inaccurate management information. As a result, Air Force management decisions based in whole or in part on this information may be adversely affected. Financial information reported by the DoD may also contain misstatements resulting from these deficiencies.

### **Compliance with Laws and Regulations**

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

#### **Audit Disclosures**

The Principal Deputy Assistant Secretary of the Air Force acknowledged to us on February 20, 2007, and on November 8, 2007, that the Air Force financial management and feeder systems cannot provide adequate evidence supporting various material amounts on the financial statements, do not fully comply with GAAP and OMB Circular A-136 "Financial Reporting Requirements," and do not record transactions initially to United States Government Standard General Ledger accounts. The Federal Financial Management Improvement Act of 1996 requires Air Force to establish and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. For FY 2007, the Air Force did not fully comply with Federal Financial Management Improvement Act of 1996.

Therefore, we did not perform detailed testing related to these previously reported instances of noncompliance. In addition, we did not perform audit work related to the selected provisions of laws and regulations contained in Appendix E of OMB Bulletin 07-04, "Audit Requirements for Federal Agencies."

This report does not include recommendations to correct the material internal control weaknesses and instances of noncompliance with laws and regulations because either previous audit reports contained recommendations for corrective actions or audit projects currently in process will include appropriate recommendations.

***For More Information***

Principal Deputy Assistant Secretary of the Air Force  
for Financial Management and  
Comptroller, Headquarters  
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***Contact Us/***

***Questions and Comments***

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