Principal Financial Statements and Notes

The principal financial statements included in this report have been prepared in accordance with the requirements of the Chief Financial Officers Act of 1990 (P.L. 101-576), the Government Management Reform Act of 1994, and the Office of Management and Budget's (OMB) Circular A-136, "Financial Reporting Requirements." The responsibility for the integrity of the financial information included in these statements rests with management of the Department of Defense. The Department's fiscal years 2005 and 2004 principal financial statements were audited by the Office of Inspector General. The auditors' report accompanies the principal statements.

The Department's principal financial statements for fiscal years 2005 and 2004 consisted of the following:

The Consolidated Balance Sheet

The Consolidated Balance Sheet, which present as of September 30, 2005 and 2004 those resources owned or managed by DoD which are available to provide future economic benefits (assets); amounts owed by DoD that will require payments from those resources or future resources (liabilities) and residual amounts retained by DoD, comprising the difference (net position).

The Consolidated Statement of Net Cost

The Consolidated Statement of Net Cost, which present the net cost of DoD operations for the years ended September 30, 2005 and 2004. DoD's net cost of operations includes the gross costs incurred by DoD less any exchange revenue earned from DoD activities.

The Consolidated Statement of Changes in Net Position

The Consolidated Statement of Changes in Net Position, which present the change in DoD's net position resulting from the net cost of DoD operations, budgetary financing sources other than exchange revenues and other financing sources for the years ended September 30, 2005 and 2004.

The Combined Statement of Budgetary Resources

The Combined Statement of Budgetary Resources, which present the budgetary resources available to DoD during FY 2005 and 2004, the status of these resources at September 30, 2005 and 2004, and the outlay of budgetary resources for the years ended September 30, 2005 and 2004.

The Consolidated Statement of Financing

The Consolidated Statement of Financing, which reconciles the net cost of operations with the obligation of budgetary resources for the years ended September 30, 2005 and 2004.

The Combined Statement of Custodial Activity

The Combined Statement of Custodial Activity, which present the sources and disposition of nonexchange revenues collected or accrued by DoD on behalf of other recipient entities for the years ended September 30, 2005 and 2004.

Limitations of Financial Statements

The following limitations apply to the preparation of the fiscal year 2005 financial statements:

The principal financial statements have been prepared to report the financial position and results of operations of the Department of Defense, pursuant to the requirements of 31 U.S.C. 3515 (b). The statements are prepared from the books and records of the Department in accordance with OMB Bulletin A-136 and to the extent possible generally accepted accounting principles. The statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

Principal Statements

CONSOLIDATED BALANCE SHEET
Department of Defense
As of September 30
($ in millions)

		2005		2004 Restated
ASSETS				
Intragovernmental				
Fund Balance with Treasury (Notes 2 and 3)	$	290,657.1	$	289,598.9
Investments (Note 4)		263,367.8		231,069.7
Accounts Receivable, Net (Note 5)		1,291.3		1,118.3
Other Assets (Note 6)		1,394.2		1,011.9
Total Intragovernmental Assets		556,710.4		522,798.8
Cash and Other Monetary Assets (Note 7)		2,072.7		2,178.1
Accounts Receivable, Net (Note 5)		7,615.5		7,427.8
Loans Receivable (Note 8)		75.6		70.7
Inventory and Related Property (Note 9)		222,573.3		220,505.6
General Property, Plant and Equipment (Note 10)		460,699.3		440,898.6
Investments (Note 4)		605.0		406.5
Other Assets (Note 6)		23,822.1		21,486.3
Total Assets	$	1,274,173.9	$	1,215,772.4
LIABILITIES				
Intragovernmental				
Accounts Payable (Note 12)	$	2,058.0	$	1,888.4
Debt (Note 13)		467.1		591.8
Other Liabilities (Notes 15 and 16)		11,150.8		10,726.9
Total Intragovernmental Liabilities		13,675.9		13,207.1
Accounts Payable (Note 12)		28,575.4		28,309.0
Military Retirement Benefits and Other Employment Related Actuarial Liabilities (Note 17)		1,736,057.8		1,569,704.7
Environmental Liabilities (Note 14)		65,027.6		64,367.2
Loan Guarantee Liability (Note 8)		41.1		34.4
Other Liabilities (Notes 15 and 16)		29,985.4		34,491.2
Total Liabilities	$	1,873,363.2	$	1,710,113.6
NET POSITION				
Unexpended Appropriations	$	271,493.6	$	243,813.9
Cumulative Results of Operations		(870,682.9)		(738,155.1)
Total Net Position	$	(599,189.3)	$	(494,341.2)
Total Liabilities and Net Position	$	1,274,173.9	$	1,215,772.4

CONSOLIDATED STATEMENT OF NET COST (Note 18)
Department of Defense
As of September 30
($ in millions)

	2005	2004
Program Costs		
Intragovernmental Gross Costs	$ 24,510.0	$ 23,574.5
(Less: Intragovernmental Earned Revenue)	(18,264.1)	(15,429.0)
Intragovernmental Net Costs	$ 6,245.9	$ 8,145.5
Gross Costs With the Public	$ 655,576.6	$ 619,573.8
(Less: Earned Revenue From the Public)	(26,943.0)	(22,354.4)
Net Costs With the Public	$ 628,633.6	$ 597,219.4
Net Cost of Operations	**$ 634,879.5**	**$ 605,364.9**

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION (Note 19)
Department of Defense
As of September 30
($ in millions)

	2005		2004	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations Restated	Unexpended Appropriations
Beginning Balances	$ (745,441.3)	$ 243,813.9	$ (621,610.7)	$ 192,955.8
Prior Period Adjustments				
Changes in Accounting Principles	3,632.4	-	699.5	-
Correction of Errors	7,256.5	-	(8,301.8)	25,913.7
Beginning Balances, as adjusted	$ (734,552.4)	$ 243,813.9	$ (629,213.0)	$ 218,869.5
Budgetary Financing Sources				
Appropriations received	$ -	$ 524,990.1	$ -	$ 512,194.5
Appropriations transferred in(out)		(651.7)		485.6
Other adjustments (recissions, etc)		(5,078.2)		(9,114.6)
Appropriations used	491,580.5	(491,580.5)	478,621.1	(478,621.1)
Nonexchange revenue	1,665.0	-	1,469.7	(0.1)
Donations and forfeitures of cash and cash equivalents	42.6	-	7.0	0.1
Transfers in(out) without reimbursement	3,176.4	-	10,568.6	-
Other budgetary financing sources	0.5	-	4,511.5	-
Other Financing Sources				
Donations and forfeitures of property	$ 1.5	$ -	$ 0.4	$ -
Transfers in(out) without reimbursement	(14.3)	-	(2,848.6)	-
Imputed financing from costs absorbed by others	4,465.3	-	4,092.5	-
Other	(2,168.5)	-	0.6	-
Total Financing Sources	$ 498,749.0	$ 27,679.7	$ 496,422.8	$ 24,944.4
Net Cost of Operations	$ 634,879.5	$ -	$ 605,364.9	$ -
Net Change	$ (136,130.5)	$ 27,679.7	$ (108,942.1)	$ 24,944.4
Ending Balance (Note 19)	**$ (870,682.9)**	**$ 271,493.6**	**$ (738,155.1)**	**$ 243,813.9**

COMBINED STATEMENT OF BUDGETARY RESOURCES (Note 20)

Department of Defense
As of September 30
($ in millions)

	2005		2004	
	Budgetary Financing Accounts	Non-Budgetary Financing Accounts	Budgetary Financing Accounts	Non-Budgetary Financing Accounts
BUDGETARY RESOURCES				
Budget Authority:				
Appropriations received	$ 604,969.5	$ -	$ 582,010.7	$ -
Borrowing authority	-	170.3	0.1	114.6
Contract authority	56,753.1	-	34,855.8	-
Net transfers	(220.0)	-	(519.3)	-
Other	-	-	-	-
Unobligated balance:				
Beginning of period	$ 73,282.9	$ 24.6	$ 256,659.0	$ 21.8
Net transfers, actual	484.5	-	782.0	-
Spending authority from offsetting collections:				
Earned:				
Collected	$ 158,928.0	$ 16.9	$ 146,274.3	$ 17.4
Receivable from federal sources	(18.2)	-	(79.7)	(0.6)
Change in unfilled customer orders:				
Advanced received	642.0	-	360.5	-
Without advance from federal sources	5,065.9	40.6	980.0	47.2
Subtotal	$ 164,617.7	$ 57.5	$ 147,535.1	$ 64.0
Recoveries of prior year obligations	$ 36,376.7	$ -	$ 33,681.9	$ -
Temporarily not available pursuant to Public Law	(31,875.4)	-	(10.0)	-
Permanently not available	(58,299.7)	(2.2)	(40,338.0)	20.7
Total Budgetary Resources	$ 846,089.3	$ 250.2	$ 1,014,657.2	$ 221.1
STATUS OFBUDGETARY RESOURCES				
Obligations Incurred:				
Direct	$ 601,516.8	$ 215.2	$ 568,053.7	$ 196.6
Reimbursable	175,983.1	-	152,658.9	-
Subtotal	$ 777,499.9	$ 215.2	$ 720,712.6	$ 196.6
Unobligated balance:				
Apportioned	$ 59,206.9	$ 1.5	$ 58,631.0	$ 1.4
Exempt from apportionment	725.9	-	183,488.1	-
Other available	(0.4)	-	0.3	-
Unobligated Balances Not Available	$ 8,657.0	$ 33.5	$ 51,825.3	$ 23.1
Total, Status of Budgetary Resources	$ 846,089.3	$ 250.2	$ 1,014,657.3	$ 221.1
Relationship of Obligations to Outlays:				
Obligated Balance, Net - beginning of period	$ 233,234.1	$ 155.7	$ 214,371.9	$ 29.9
Obligated Balance transferred, net	-	-	(14.1)	-
Obligated Balance, Net - end of period:				
Accounts Receivable	$ (10,118.7)	$ -	$ (10,136.8)	$ -
Unfilled customer order from federal sources	(44,468.0)	(123.7)	(39,402.0)	(83.1)
Undelivered orders	250,153.2	446.3	228,801.3	238.8
Accounts payable	50,292.3	-	53,470.6	-
Outlays:				
Disbursements	$ 723,450.6	$ 7.7	$ 667,755.1	$ 24.1
Collections	(159,570.1)	(16.9)	(146,634.7)	(17.4)
Subtotal	$ 563,880.5	$ (9.2)	$ 521,120.4	$ 6.7
Less: Offsetting receipts	(55,072.9)	-	(46,546.4)	-
Net Outlays	$ 508,807.6	$ (9.2)	$ 474,574.0	$ 6.7

CONSOLIDATED STATEMENT OF FINANCING (Note 21)
Department of Defense
As of September 30
($ in millions)

		2005		2004
Resources Used to Finance Activities				
Bugetary Resources Obligated	$	777,715.1	$	720,909.2
Obligations incurred				
Less: Spending authority from offsetting collections and recoveries		(201,052.5)		(181,281.0)
Obligations net of offsetting collections and recoveries		576,662.6		539,628.2
Less: Offsetting receipts		(55,072.9)		(46,546.4)
Net Obligations		521,589.7		493,081.8
Other Resources				
Donations and forfeitures of property	$	1.5	$	0.4
Transfers in(out) without reimbursement		(14.3)		(2,848.6)
Imputed financing from costs absorbed by others		4,465.3		4,092.5
Other		(2,168.5)		0.6
Net other resources used to finance activities		2,284.0		1,244.9
Total Resources used to finance activities	**$**	**523,873.7**	**$**	**494,326.7**
Resources Used to Finance Items not Part of the Net Cost of Operations				
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided				
Undelivered Orders	$	(42,391.5)	$	(13,925.6)
Unfilled Customer Orders		5,748.6		1,387.4
Resources that fund expenses recognized in prior periods		(2,610.0)		(2,637.4)
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations		3,325.1		2,645.4
Resources that finance the acquisition of assets		(112,714.7)		(86,943.6)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations				
Less: Trust or Special Fund Receipts Related to Exchange		(10.0)		(10.0)
Other		2,176.3		2,855.5
Total resources used to finance items not part of the Net Cost of Operations	$	(146,476.2)	$	(96,628.3)
Total resources used to finance the Net Cost of Operations	$	377,397.5	$	397,698.4
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period				
Components Requiring or Generating Resources in the Future Period:				
Increase in annual leave ability	$	615.1	$	514.8
Increase in environmental and disposal liability		1,100.3		3,864.6
Upward(Downward) reestimates of credit subsidy expense		-		14.9
Increase in exchange revenue receivable from the public		40.5		(73.8)
Other		168,069.4		139,064.9
Total components of Net Cost of Operations that will require or generate resources in future periods	$	169,825.3	$	143,385.4
Components not Requiring or Generating Resources:				
Depreciation and amortization	$	48,944.0	$	42,249.2
Revaluation of assets and liabilities		1,775.1		(5,712.6)
Other				
Trust Fund Exchange Revenue		(26,007.0)		(24,285.4)
Cost of Goods Sold		46,172.4		41,421.8
Operating Materials and Supplies Used		246.8		4,655.9
Other		16,525.4		5,952.2
Total components of Net Cost of Operations that will require not require or generate resources	$	87,656.7	$	64,281.1
Total components of Net cost of Operations that will not require or generate resources in the current period	$	257,482.0	$	207,666.5
Net Cost of Operations	$	634,880	$	605,365

COMBINED STATEMENT OF CUSTODIAL ACTIVITY (Note 22)
Department of Defense
As of September 30
($ in millions)

	2005	2004
SOURCE OF COLLECTIONS		
Deposits by Foreign Governments	$ 10,693.1	$ 11,237.5
Seized Iraqi Cash	-	118.3
Total Cash Collections	10,693.1	11,355.8
Accrual Adjustments	-	0.9
Total Custodial Collections	$ 10,693.1	$ 11,356.7
DISPOSITION OF COLLECTIONS		
Disbursed on Behalf of Foreign Governments and International Organizations	$ 11,070.7	$ 9,998.8
Seized Assets Disbursed on behalf of Iraqi People	52.1	283.1
Increase (Decrease) in Amounts to be Transferred	(377.6)	1,239.5
Seized Assets Retained for Support of the Iraqi People	(52.1)	(164.7)
Total Disposition of Collections	$ 10,693.1	$ 11,356.7
NET CUSTODIAL COLLECTION ACTIVITY	$ -	$ -

Notes to the Principal Statements

Note 1 - Significant Accounting Policies

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Department of Defense (DoD), as required by the Chief Financial Officers Act of 1990, expanded by the Government Management Reform Act of 1994, and other appropriate legislation. The financial statements have been prepared from the books and records of the Department in accordance with the "DoD Financial Management Regulation," Office of Management and Budget Circular A-136, (Financial Management Reporting Requirements), and to the extent possible generally accepted accounting principles (GAAP). The accompanying financial statements account for all resources for which the Department is responsible. Starting in FY 2005, the Department's Statements of Financing is presented as Consolidated and Consolidating in accordance with OMB Circular A-136. The methodology used to compute the line amounts has not changed from prior years. 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 no longer classified.

The Department is unable to fully implement all elements of GAAP and Office of Management and Budget Circular A-136 due to limitations of its financial management processes and systems, and non-financial systems and processes that feed into the financial statements. The Department derives its reported values and information for major asset and liability categories largely from non-financial systems, such as inventory systems and logistics systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with GAAP. The Department continues to implement process and system improvements addressing these limitations. The Department currently has 11 auditor-identified financial statement material weaknesses: (1) Financial Management Systems, (2) Intragovernmental Eliminations, (3) Accounting Entries, (4) Fund Balance with Treasury, (5) Environmental Liabilities, (6) General Property, Plant and Equipment, (7) Government Property and Material in Possession of Contractors, (8) Inventory, (9) Operating Materials and Supplies, (10) Statement of Net Cost, and (11) Statement of Financing.

1.B. Mission of the Reporting Entity

The National Security Act of 1947 established the Department of Defense. The Department's mission is to organize, train, and equip armed forces to deter aggression and, if necessary, defeat aggressors against the United States and its allies. Fiscal year (FY) 2005 is the 10th year that the Department has prepared audited DoD Agencywide financial statements as required by the Chief Financial Officers Act and Government Management Reform Act. Auditors are required to audit the financial statements of the following stand-alone reporting entities: (1) Army General Fund, (2) Army Working Capital Fund, (3) Navy General Fund, (4) Navy Working Capital Fund, (5) Air Force General Fund, (6) Air Force Working Capital Fund, (7) Military Retirement Fund, (8) DoD Medicare-Eligible Retiree Health Care Fund, and (9) U.S. Army Corps of Engineers (Civil Works).

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

The Department requires the following Defense Agencies to prepare internal stand-alone auditable financial statements: (1) Defense Logistics Agency, (2) Defense Finance and Accounting Service, (3) Defense Information Systems Agency, (4) Defense Contract Audit Agency, (5) Defense Commissary Agency, (6) Defense Security Service, (7) Defense Threat Reduction Agency, (8) Defense Advanced Research Projects Agency, (9) Chemical Biological and Defense Program, and (10) Missile Defense Agency.

1.C. Appropriations and Funds

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

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

Working capital funds (WCFs) receive their initial funding through an appropriation or a transfer of resources from existing appropriations or funds and use those capital resources to finance the initial startup. The WCF entities provide goods and services on a reimbursable basis. Reimbursable receipts fund ongoing operations and generally are available in their entirety for use without further Congressional action.

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

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

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

1.D. Basis of Accounting

For FY 2005, the Department's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the Department's financial and non-financial feeder systems and processes were designed and implemented prior to the issuance of GAAP for federal agencies and, therefore, were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP. Most of the Department's legacy systems were designed to record information on a budgetary basis.

The Department has undertaken efforts to determine the actions required to bring its financial and non-financial 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 United States Standard General Ledger (USSGL). Until all of the Department's financial and non-financial feeder systems and processes are updated to collect and report financial information as required by GAAP, the DoD's financial data will be based on budgetary transactions (obligations, disbursements, and collections), transactions from non-financial feeder systems, and adjustments for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities.

In addition, the Department identifies program costs based upon the major appropriation groups provided by the Congress. Current processes and systems do not capture and report accumulated costs for major programs based upon the performance measures as required by the Government and Performance and Results Act (GPRA). The Department is in the process of reviewing available data and attempting to develop a cost reporting methodology that balances the need for cost information required by GPRA and the Statement of Federal Financial Accounting Standard (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," with the need to keep the financial statements from being overly voluminous.

1.E. Revenues and Other Financing Sources

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

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

1.F. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. However, because the Department's financial and non-financial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, environmental liabilities, and unbilled revenue. The Department's expenditures for capital and other long-term assets are recognized as operating expenses based on depreciation. In the case of Operating Materials and Supplies (OM&S), operating expenses are generally recognized when the items are purchased. Efforts are underway to migrate 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 the Department or between two or more federal agencies. However, the Department cannot accurately identify most of its intragovernmental transactions by customer because DoD's systems do not track buyer and seller data needed to match related transactions. Seller entities within the Department 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. Intra-DoD intragovernmental balances are then eliminated. Starting in FY 2005, the Department properly eliminates the revenue resulting from intra-DoD sales of capitalized assets. The Department is developing long-term systems improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished effectively with the existing or foreseeable resources.

The Department of the Treasury Financial Management Service (FMS) is responsible for eliminating transactions between the Department and other federal agencies. The Treasury Financial Manual Part 2 – Chapter 4700 "Agency Reporting Requirements for the Financial Report of the United States Government," and the Treasury's "Federal Intragovernmental Transactions Accounting Policies Guide," provide guidance for reporting and reconciling intragovernmental balances. While the Department is unable to fully reconcile intragovernmental transactions with all federal partners, the Department is able to reconcile balances pertaining to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor (DoL), and benefit program transactions with the Office of Personnel Management (OPM). The Department's proportionate share of public debt and related expenses of 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 Department of the Treasury does not allocate such interest costs to the benefiting agencies.

1.H. Transactions with Foreign Governments and International Organizations

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

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

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

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

1.J. Foreign Currency

Cash is the total of cash resources under the control of the Department of Defense, which includes coin, paper currency, negotiable instruments, and amounts held for deposit in banks and other financial institutions. Foreign currency consists of the total U.S. dollar equivalent of both purchased and non-purchased foreign currencies held in foreign currency fund accounts.

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

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

1.K. Accounts Receivable

As presented in the Balance Sheet, accounts receivable includes accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. The Department does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies (per the Code of Federal Regulations 4 CFR 101).

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

1.L. Loans Receivable

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

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

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

1.M. Inventories and Related Property

Most of the Department's inventories are currently reported at an approximation of historical cost using latest acquisition cost adjusted for holding gains and losses. The latest acquisition cost method is used because legacy inventory systems were designed for materiel management rather than accounting. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with SFFAS No. 3, "Accounting for Inventory and Related Property." Additionally, these systems cannot produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). By utilizing new systems development processes, the DoD components have transitioned, and are continuing to transition, their inventory to the moving average cost method. Upon full implementation, the Department will be compliant with SFFAS No. 3. Approximately 35 percent of the Department's inventory value is now being reported from systems that have transitioned to moving average cost functionality. However, since the on-hand balances which transitioned were not, for the most part, baselined to auditable historical cost, the reported values remain noncompliant with SFFAS No. 3 and GAAP.

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

Related property includes operating materials and supplies (OM&S) and stockpile materials. OM&S, including munitions not held for sale, are valued at standard purchase price. The Department uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored such as ammunition and engines, are generally recorded using the consumption method and reported on the Balance Sheet as OM&S. When current systems cannot fully support the consumption method, the Department uses the purchase method - that is, materials and supplies are expensed when purchased. For FY 2005, the Department expensed significant amounts using the purchase method either because the systems could not support the consumption method or because management deemed that the item was in the hands of the end user.

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

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

Past audits identified uncertainties about the completeness and existence of the reported values of inventory. Inventory available and purchased for resale includes consumable spare and repair parts and repairable items owned and managed by the Department. This inventory is retained to support military or national contingencies. Inventory held for repair is damaged inventory that requires repair to make suitable for sale. It is more economical to repair than to procure these inventory items. Because the Department often relies on weapon systems and machinery no longer in production, the Department supports a process that encourages the repair and rebuilding of certain items. This repair cycle is essential to maintaining a ready, mobile, and armed military force. Finally, work in process balances include costs related to the production or servicing of items, including direct materiel, 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 amounts paid to contractors under cost reimbursable contracts, including 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 in U.S. Treasury Securities

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

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

The Department's Net Investments are supported by various Trust Funds in each of the reporting entities. These Trust Funds are comprised of the Military Retirement Trust Fund (MRF); Medicare-Eligible Retiree Health Care Fund (MERHCF); Other Defense Organizations General Fund (ODO GF) trust funds; donations (Gift Funds); and the USACE South Dakota Terrestrial Habitat Restoration, Inland Waterways, and Harbor Maintenance Trust Fund accounts

1.O. General Property, Plant and Equipment

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

General Plant, Property, and Equipment (PP&E) assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of 2 or more years, and when the acquisition cost equals or exceeds the DoD capitalization threshold of $100,000, except for the USACE and WCF as discussed below. Also, the DoD requires capitalization of improvement costs over the DoD capitalization threshold of $100,000 to General PP&E. The Department depreciates all General PP&E, other than land, on a straight-line basis.

Prior to FY 1996, General PP&E was capitalized if it had an acquisition cost of $15,000, $25,000, and $50,000 for FYs 1993, 1994, and 1995, respectively, and an estimated useful life of 2 or more years. General PP&E previously capitalized at amounts below $100,000 were written off General Fund financial statements in FY 1998. No adjustment was made for WCF assets. These assets remain capitalized and reported on WCF financial statements.

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

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

The Department is developing new policies and a contractor reporting process that will provide appropriate General PP&E information for future financial statement reporting purposes. Accordingly, the Department reports only the government property in the possession of contractors that is maintained in the DoD's property systems.

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

1.P. Advances and Prepayments

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

1.Q. Leases

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

Office space and leases entered into by the Department in support of contingency operations are the largest components of operating leases. These costs were gathered from existing leases, General Service Administration (GSA) bills, and Inter-service Support Agreements. Future year projections use the Consumer Price Index (CPI), rather than the DoD inflation factor. The CPI impacts increases to the leases, especially those at commercial lease sites. Equipment leases have a variety of lease terms, which are not expected to be renewed upon expiration. Other operating leases are generally 1-year leases. The Department expects to continue to reduce the level of owned assets while increasing the number of leased assets. The Department will strive to displace commercial leases with more economical GSA leases.

1.R. Other Assets

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

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

1.S. Contingencies and Other Liabilities

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," 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 DoD recognizes contingencies as liabilities when past events or exchange transactions occur, a future loss is probable and the loss amount can be reasonably estimated.

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

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

1.T. Accrued Leave

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

1.U. Net Position

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

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

Cumulative Results of Operations represent the difference, since inception of an activity, between expenses and losses and financing sources (including appropriations, revenue, and gains). Beginning with FY 1998, these results included the cumulative amount of donations and transfers of assets in and out without reimbursement.

1.V. Treaties for Use of Foreign Bases

The DoD components have the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. The Department purchases capital assets overseas with appropriated funds; however, the host country retains title to land and improvements. Generally, treaty terms allow the DoD components continued use of these properties until the treaties expire. In the event treaties or other agreements are terminated, whereby use of the foreign bases is prohibited, losses are recorded for the value of any non-retrievable capital assets. This takes place after negotiations between the U.S. and the host country have determined the amount to be paid to the U.S. for such capital investments.

1.W. Comparative Data

Financial statement fluctuations greater than 2 percent of total assets on the Balance Sheet or 10 percent from the previous period presented are generally explained within the Notes to the Financial Statements.

1.X. Unexpended Obligations

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

1.Y. Undistributed Disbursements and Collections

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

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

Note 2 - Nonentity Assets

As of September 30	2005	2004
	(Amounts in millions)	
Intragovernmental Assets		
Fund Balance with Treasury	$1,653.5	$1,913.5
Accounts Receivable	0.3	8.2
Total Intragovernmental Assets	**1,653.8**	**1,921.7**
Nonfederal Assets		
Cash and Other Monetary Assets	1,959.4	2,079.6
Accounts Receivable	4,469.6	5,107.7
Other Assets	156.9	0.6
Total Nonfederal Assets	6,585.9	7,187.9
Total Nonentity Assets	**8,239.7**	**9,109.6**
Total Entity Assets	**1,265,934.2**	**1,206,662.9**
Total Assets	**$1,274,173.9**	**$1,215,772.5**

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

Fluctuations

Nonentity Fund Balance with Treasury decreased a net of $260 million (14 percent). The decrease is primarily due to the reclassification of Budget Clearing Accounts from Nonentity to Entity assets, $143.3 million in

FY 2005. The Department also misclassified $61.6 million of Deposit Funds as Entity versus Nonentity funds in FY 2005. The Department also disbursed $52.1 million of Iraqi seized funds for support of the Iraqi people in FY 2005.

Nonfederal Accounts Receivable decreased $638.2 million (12 percent). This decrease represents receivables on appropriations that closed. The decrease is due to management initiatives and emphasis in identifying valid accounts receivable and taking the appropriate corrective action to collect these receivables.

Nonfederal Other Assets increased $156.3 million (261 percent). The increase is attributed to the reclassification of advances to contractors to Other Assets.

Other Disclosures

Intragovernmental Assets

Nonentity Fund Balance With Treasury is comprised of four elements: Iraqi Custodial Fund, Development Fund for Iraq, Foreign Military Sales (FMS) Trust Fund, and deposit and specific suspense accounts. The Iraqi Custodial Fund represents Iraqi cash seized by coalition forces during Operation Iraqi Freedom. The Development Fund for Iraq contains funds transferred from the Interim Iraqi Government to the Multi-National Force-Iraq. These funds are used to support the Iraqi people. Under authority of the Arms Export and Control Act, the FMS Trust Fund receives collections from foreign governments that are dedicated specifically to FMS purchases. The deposit and suspense accounts primarily represent various deposits and Thrift Savings Plan balances.

The Nonentity accounts receivable are primarily from cancelled year appropriations. These receivables will be returned to the Treasury as miscellaneous receipts once collected.

Non-Federal Assets

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

Nonentity Accounts Receivable are primarily related to accrued interest on advance payments made to contractors which remain in litigation; long-term receivables due from state and local municipalities for water storage contracts, hydraulic mining, and the leasing of land for flood control purposes; and accrued interest, penalties, fines and administrative fees receivable.

Nonentity Other assets primarily represent advances to contractors as part of an advance-payment pool agreement with Massachusetts Institute of Technology and other nonprofit institutions. 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.

Note 3 - Fund Balance with Treasury

As of September 30	2005	2004
	(Amounts in millions)	
Fund Balances		
Appropriated Funds	$278,565.8	$267,067.5
Revolving Funds	8,249.0	9,036.3
Trust Funds	406.2	1,955.5
Special Funds	344.3	0.0
Other Fund Types	3,091.8	11,539.6
Total Fund Balances	**290,657.1**	**289,598.9**
Fund Balances Per Treasury Versus Agency		
Fund Balance per Treasury	294,103.0	293,082.2
Fund Balance per	290,657.1	289,598.9
Reconciling Amount	**$3,445.9**	**$3,483.3**

	2005			2004
Reporting Entity	Fund Balance with Treasury	Fund Balance per Entity Books	Reconciling Amount	Reconciling Amount
	(Amounts in millions)			
Navy GF	$86,922.1	$86,079.2	$842.9	$986.4
Air Force GF	63,268.8	62,350.2	918.6	896.8
Army GF	87,795.0	87,093.3	701.7	
ODO GF	48,732.8	47,784.2	948.6	1,055.7
Corps of Engineers	3,180.2	3,146.1	34.1	520.3
MERHCF	5.0	5.0		
MRF	22.9	22.9		
Air Force WCF	1,038.6	1,164.2	(125.6)	652.8
Army WCF	623.3	623.3		
ODO WCF	1,536.4	1,410.8	125.6	(628.7)
Navy WCF	977.9	977.9		
Total	**$294,103.0**	**$290,657.1**	**$3,445.9**	**$3,483.3**

Analysis of Reconciling Amounts

The Department of Defense (DoD) shows a reconciling net difference of $3.4 billion with the Department of the Treasury, which is comprised of:

- $842.9 million, for the Navy General Fund (GF), that is primarily from $792.3 million in canceling appropriated authority withdrawn by the Department of the Treasury at the end of the fiscal year and $50.6 million in receipt account transactions unavailable to the Navy.

- $918.6 million, for the Air Force GF, that is primarily from $783.3 million in canceling appropriated authority withdrawn by the Department of the Treasury at the end of the fiscal year and $123.8 million in preclosed receipt account balances.

- $701.7 million, for the Army GF, primarily from a combination of $555.1 million in canceling appropriated authority withdrawn by the Department of the Treasury at the end of the fiscal year and $166.8 million in receipt account transactions unavailable to the Army, reduced by $52.3 million in parent transfers reported in the fund balance for Army but not in the fund balance per Treasury for Army.

- $948.6 million, for the Other Defense Organizations (ODO) GF, that primarily consists of the net of the positive reconciling difference for the DoD component level accounts offset by the aggregated negative reconciling difference of approximately 50 defense agencies and organizations.

- $34.1 million, for the US Army Corps of Engineers, consisting of approximately $83.8 million in parent account allocations for the reporting of trust funds (Inland Waterways and Harbor Maintenance) for the Bureau of Public Debt offset by $117.9 million in preclosed receipt account balances.

- ($125.6) million, for the Air Force Working Capital Fund (WCF) and an offsetting $125.6 million for the ODO Working Capital Fund. These reconciling differences represent the Fund Balance with Treasury for the United States Transportation Command, which is reported to the Treasury as part of the Air Force Working Capital Fund. The accounting for these funds is actually performed within the entity Financial Statements of ODO Working Capital Fund. For financial reporting, the Fund Balance with Treasury for the ODO Working Capital Fund is adjusted downward to reconcile with the Air Force Working Capital Fund.

Other Information Related to Fund Balance with Treasury

The Army General Fund includes approximately $34.7 million in Vested Iraqi Cash. This cash represents frozen Iraqi deposits in the United States and is vested in accordance with the International Emergency Economic Powers Act, Section 1701, and is used in support of the Iraqi people. The Army has collected $1.7 billion in Vested Iraqi Cash and has disbursed $1.7 billion benefiting the Iraqi people as follows:

	Disbursed *($ in millions)*
Iraqi Salaries	$1,184.8
Repair/Reconstruction/Humanitarian Assistance	147.8
Iraqi Ministry Operations (Ministry of Finance, Defense, etc.)	356.8
Total Disbursed	**$1,689.4**

Special Funds increased to approximately $341.3 million from zero. Special Funds is a new category for FY 2005. These funds are receipt and expenditure accounts used to obligate and expend for special programs in accordance with specific provisions of law. Amounts reported in FY 2004 for these funds were reported in one of the other four categories.

The Other Fund Types decreased approximately $8.4 billion (73 percent) primarily as a result of reclassifying the Iraqi Relief and Reconstruction Fund from Other Fund Types to Appropriated Funds. The Iraqi Relief and Reconstruction Fund reported a balance of $9.4 billion in FY 2004.

Status of Fund Balance with Treasury		
As of September 30	**2005**	**2004**
	(Amounts in millions)	
Unobligated Balance		
Available	$59,934.1	$248,483.7
Unavailable	8,690.4	45,485.4
Obligated Balance not yet Disbursed	556,162.3	284,832.8
Non-Budgetary FBWT	8,783.4	1,913.5
Non-FBWT Budgetary Accounts	(342,387.7)	(302,305.5)
Total	**$291,182.5**	**$278,409.9**

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

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

Obligated Balance not yet Disbursed represents funds that have been obligated for goods that have not been received or services that have not been performed.

Non-Budgetary Fund Balance with Treasury (FBWT) includes entity and nonentity FBWT accounts which do not have budgetary authority, such as unavailable receipt accounts or clearing accounts.

Non-FBWT Budgetary Accounts include budgetary accounts that do not affect FBWT, such as contract authority, borrowing authority and investment accounts. This category reduces the Status of Fund Balance with Treasury.

Fluctuations

Many of fluctuations are due to a further breakout of this note to comply with recently published Office of Management and Budget Circular A-136, to more closely reconcile the budgetary and proprietary aspect of Fund Balance with Treasury with the President's Budget. Specifically, the last categories (Lines 3 and 4) have been added. In addition, various accounts previously reported on Lines 1 and 2 have been transferred to Lines 3 and 4 and new accounts have been added. These changes are intended to more closely reconcile the budgetary and proprietary aspects of FBWT.

Disclosures Related to Suspense/Budget Clearing Accounts				
As of September 30	**2003**	**2004**	**2005**	**Decrease/Increase from FY 2004 - 2005**
Account	*(Amounts in millions)*			
F3875	($628.8)	($608.5)	$263.5	$872.0
F3880	(6.0)	(1.4)	11.9	13.3
F3882	(21.6)	(59.5)	83.5	143.0
F3885	(399.5)	(118.2)	(211.6)	(93.4)
F3886	0.2	0.2	(4.9)	(5.1)
Total	**($1,055.7)**	**($787.4)**	**$142.4**	**$929.8**

A description of the suspense and budget clearing accounts and their respective balances follows:
Account F3875 reported a positive balance of approximately $263.5 million that represents the Disbursing Officer's (DO) suspense. Account F3885, which includes the Interfund/IPAC suspense transactions, reported a negative balance of approximately $211.6 million. Account F3886 has a negative balance of approximately $4.9 million represented by the (payroll) Thrift Savings Plan suspense. These three suspense accounts temporarily hold collections or disbursements until they can be assigned or identified to a valid appropriation.

The F3880 suspense account reported a positive balance of approximately $11.9 million. This amount represents the balance of Treasury checks that (1) have either been lost by the payee and need to be reissued, (2) have never been cashed by the payee, or (3) have been cancelled by the Treasury and need to be transferred to the original appropriation.

The F3882 suspense account reported a positive balance of approximately $83.5 million. This account was established for the Uniformed Services Thrift Savings Plan in FY 2002. The amounts in this account represent a timing difference between the posting of the Thrift Savings Plan deductions by the U.S.D.A. National Finance Center and the posting of these same amounts in the military accounting systems in the following month.

Disclosures Related to Problem Disbursements and In-Transit Disbursements				
As of September 30	**2003**	**2004**	**2005**	**Decrease/Increase from FY 2004 - 2005**
	(Amounts in millions)			
Total Problem Disbursements, Absolute Value				
Unmatched Disbursements (UMDS)	$854.3	$734.6	$2,221.9	$1,487.3
Negative Unliquidated Obligations (NULO)	124.9	94.8	95.1	0.3
Total In-transit Disbursements, Net	**$4,675.5**	**$5,197.8**	**$4,557.5**	**($640.3)**

The DoD reported $2.2 billion (absolute value) in UMDs, which is an increase of $1.5 billion. A UMD occurs when a payment is not matched to a corresponding obligation in the accounting system. Absolute value is the sum of the positive values of debit and credit transactions without regard to the sign (plus or minus).

The DoD reported $95.1 million (absolute value) in NULOs, which is an increase of $0.3 million. A NULO occurs when a payment is made against a valid obligation, but the payment is greater than the amount of the obligation recorded in the official accounting system. These payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

The DoD reported $4.6 billion (net) for In-transits, which is a decrease of $640.3 million. The In-transits represent the net value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity and have not been posted to the accounting system.

Note 4 - Investments and Related Interest

	2005					**2004**
As of September 30	**Par Value/ Cost**	**Amortization Method**	**Unamortized (Premium/ Discount)**	**Investments, Net**	**Market Value Disclosure**	**Investments, Net**
	(Amounts in millions)					
Intragovernmental Securities						
Non-Marketable, Market Based	$234,915.8	Effective Interest	$24,509.0	$259,424.8	$262,243.7	$227,069.5
Accrued Interest	3,943.0			3,943.0	3,943.0	4,000.2
Total Intragovernmental Securities	238,858.8		24,509.0	263,367.8	266,186.7	231,069.7
Other Investments	605.0		0.0	605.0	N/A	406.5

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

Intragovernmental Securities

Net Investments increased $32.3 billion (14 percent) in non-marketable, market-based securities. This increase is primarily due to positive cash flows of $22.1 billion for the Medicare-Eligible Retiree Health Care Fund, $9.8 billion for the Military Retirement Fund, and $0.4 billion for the Inland Waterways, Harbor Maintenance, and South Dakota Terrestrial Wildlife Habitat Restoration Trust Funds.

Other Investments

Other Investments increased $198.5 million (49 percent) from new investments in limited partnerships by the Army ($163.9 million) and Navy ($34.6 million) in support of military housing. A summary of the Department's total investments in these limited partnerships follows:

Installation	Q4 FY 2004 Balance	Month Invested	New Investments	Month Invested	Q4 FY 2005 Total
Beaufort/Paris ISL/Quantico	97.1	Oct-03			$ 7.1
Ft. Campbell, Kentucky *	52.2	Jan-04	$7.9	Mar-05	60.1
Ft. Hood, Texas	52.0	Nov-01			52.0
Ft. Bragg, North Carolina	49.4	Dec-03			49.4
Ft. Stewart, Georgia	37.4	Feb-04			37.4
South Texas, Texas	29.4	Feb-02			29.4
New Orleans Naval Complex, Louisiana	23.1	Oct-01			23.1
San Diego, California	20.9	Jun-03			20.9
Everett NAS, Washington	12.2	Dec-00			12.2
Kingsville NAS, Texas	4.3	Dec-00			4.3
Ft. Hamilton, New York	2.2	May-04			2.2
Ft. Detrick, Maryland	1.3	Sep-04			1.3
Ft. Polk, Louisiana*			53.6	Feb-05	53.6
Oahu, Hawaii	25.0	May-04			25.0
Yuma Naval Air Station **			18.7	Dec-04	18.7
Pacific Northwest **			15.9	Mar-05	15.9
Ft. Sam Houston, Texas*			6.6	Jun-05	6.6
Ft. Eustis, Virginia*			14.8	Apr-05	14.8
Ft. Drum, New York*			52.0	Jun-05	52.0
Ft. Leonard Wood, Missouri*			29.0	Sep-05	29.0
TOTALS	**$406.5**		**$198.5**		**$605.0**

**Army investments in FY 2005*
***Navy investments in FY 2005*

Note 5 - Accounts Receivable

As of September 30	2005			2004
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
	(Amounts in millions)			
Intragovernmental Receivables	$1,291.3	N/A	$1,291.3	$1,118.3
Nonfederal Receivables (From the Public)	7,990.7	(375.2)	7,615.5	7,427.8
Total Accounts Receivable	**$9,282.0**	**($375.2)**	**$8,906.8**	**$8,546.1**

Fluctuations

Intragovernmental receivables increased $173.0 million (16 percent). This was primarily due to increased receivables for support provided to the Federal Emergency Management Agency (FEMA) for hurricane relief efforts in the Gulf Coast. The support provided was in a broad range of areas, including helicopter search and rescue operations, medical assistance, contract medical support, and the provision of food, water, and other supplies.

Note 6 - Other Assets

As of September 30	2005	2004
	(Amounts in millions)	
Intragovernmental Other Assets		
Advances and Prepayments	$1,394.2	$1,011.9
Total Intragovernmental Other Assets	1,394.2	1,011.9
Nonfederal Other Assets		
Outstanding Contract Financing Payments	21,776.1	18,451.6
Other Assets (With the Public)	2,046.0	3,034.7
Total Nonfederal Other Assets	23,822.1	21,486.3
Total Other Assets	**$25,216.3**	**$22,498.2**

Fluctuations

<u>Intragovernmental Other Assets</u>
Advances and Prepayments increased $382.3 million (38 percent). This increase is primarily attributed to the improved visibility in identifying and recording government advances to the Departments of Interior, Transportation and Homeland Security that are procuring goods and services for the Department of Defense.

Nonfederal Other Assets
Outstanding Contract Financing Payments increased $3.3 billion (18 percent). The increase is attributable to the acquisition of the V-22 Osprey and F/A-18 Hornet aircraft and the replenishment of weapons, ammunition, missiles, and combat vehicles.

Other Assets (With the Public) decreased $988.7 million (33 percent). This is primarily due to increased collection efforts of outstanding travel advances, a decrease in the amount of returns to vendors pending credit, and the reclassification from Other Assets (With the Public) for Foreign Military Sales to Nonfederal Accounts Receivable and progress payments to Outstanding Contract Financing Payments.

Note 7 - Cash and Other Monetary Assets

As of September 30	2005	2004
	(Amounts in millions)	
Cash	$1,494.0	$1,811.1
Foreign Currency (non-purchased)	578.7	367.0
Total Cash, Foreign Currency, and Other Monetary Assets	**$2,072.7**	**$2,178.1**

Other Information

The majority of cash and all foreign currency are classified as nonentity and their use is, therefore, restricted. Approximately $1.38 billion in cash and $578.7 million in foreign currency are restricted.

Note 8 - Direct Loan and/or Loan Guarantee Programs

As of September 30

The Department operates the following direct loan and/or Loan guarantee program(s)
- Military Housing Privatization Initiative
- Armament Retooling & Manufacturing Support Initiative

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

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

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

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

Military Housing Privatization Initiative

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

Armament Retooling and Manufacturing Support Initiative

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

Direct Loans Obligated After FY 1991		
As of September 30	**2005**	**2004**
Loan Programs	*(Amounts in millions)*	
Military Housing Privatization Initiative		
Loans Receivable Gross	$141.5	$141.5
Interest Receivable	0.0	0.0
Foreclosed Property	0.0	0.0
Allowance for Subsidy Cost (Present Value)	(65.9)	(70.8)
Value of Assets Related to Direct Loans	75.6	70.7
Total Loans Receivable	**$75.6**	**$70.7**

Subsidy costs are recognized when direct loans are disbursed to borrowers and are re-estimated each year as of the date of the financial statements. The allowance for subsidy cost is the difference between the outstanding principal of the loans and the present value of their net cash flows. The decrease in the allowance for subsidy is the result of FY 2005 subsidy re-estimates and subsidy amortization. Interest subsidy amortization is the net of interest revenue and interest expense. The subsidy amortization represents the difference between net borrowing from Treasury and gross loans receivable. For additional information, see the Schedule for Reconciling Subsidy Cost Allowance Balances for Post-1991 Direct Loans.

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

	(in Millions)
Dyess Air Force Base, Texas	$28.9
Elmendorf Air Force Base, Alaska	48.0
Lackland Air Force Base, Texas	10.4
Robins Air Force Base, Georgia	22.3
Camp Pendleton Marine Corps Base, California	29.4
Kingsville Air Force Base, Texas	2.5
Total Loans Receivable Gross	**$141.5**

Total Amount of Direct Loans Disbursed		
As of September 30	**2005**	**2004**
Direct Loan Programs	*(Amounts in millions)*	
Military Housing Privatization Initiative	0.0	12.4
Total	**0.0**	**12.4**

The Department disbursed no new direct loans in the current fiscal year. The demand for direct loans by private developers varies from year to year depending upon the progression of planned construction and renovation, and upon economic factors unrelated to the operations of the Department of Defense.

Subsidy Expense for Post-1991 Direct Loans					
As of September 30 *(Amounts in millions)*					
2004	**Interest Differential**	**Defaults**	**Fees**	**Other**	**Total**
1. New Direct Loans Disbursed:					
Military Housing Privatization Initiative	7.7	0.5	0.0	0.0	8.2
2005	**Modifications**	**Interest Rates**	**Technical Reestimates**	**Total Reestimates**	**Total**
2. Direct Loan Modifications and Reestimates:					
Military Housing Privatization Initiative	(0.3)	(0.9)	(3.6)	(4.5)	(4.8)
2004					
3. Direct Loan Modifications and Reestimates:					
Military Housing Privatization Initiative	(0.7)	(2.0)	0.1	(1.9)	(2.6)

	2005	**2004**
4. Total Direct Loan Subsidy Expense:		
Military Housing Privatization Initiative	(4.8)	5.6

The total subsidy expense for direct loans decreased by $10.5 million (187 percent) due to no new direct loans disbursed in FY 2005 and an increase in the downward re-estimate. The total direct loan subsidy expense includes interest differential, defaults, modification and re-estimates.

Subsidy Rate for Direct Loans					
As of September 30	Interest Differential	Defaults	Fees	Other	Total
Military Housing Privatization Initiative	24.17%	9.78%	0.00%	0.00%	33.95%

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

Schedule for Reconciling Subsidy Cost Allowance Balances for Post-1991 Direct Loans		
As of September 30	2005	2004
	(Amounts in millions)	
Beginning Balance of the Subsidy Cost Allowance	$70.7	$65.1
Add: Subsidy Expense for Direct Loans Disbursed during the Reporting Years by Component		
Interest Rate Differential Costs	0.0	7.7
Default Costs (Net of Recoveries)	0.0	0.5
Total of the above Subsidy Expense Components	0.0	8.2
Adjustments		
Subsidy Allowance Amortization	(0.3)	(0.6)
Total of the above Adjustment Components	(0.3)	(0.6)
Ending Balance of the Subsidy Cost Allowance before Re-estimates	70.4	72.7
Add or Subtract Subsidy Re-estimates by Component		
Interest Rate Re-estimate	(0.9)	(2.0)
Technical/default Re-estimate	(3.6)	0.1
Total of the above Re-estimate Components	(4.5)	(1.9)
Ending Balance of the Subsidy Cost Allowance	**$65.9**	**$70.8**

Subsidy Expense

The total decrease of $8.2 million (100 percent) relates to zero direct loans issued in FY 2005 compared to one loan in FY 2004.

Adjustments

The total increase of $0.3 million (52 percent) in subsidy allowance amortization resulted from internal analysis which computed the Interest Revenue (Treasury and Borrower) less Interest Expense (Interest to Treasury on borrowed funds). This adjustment can increase or decrease subsidy costs.

Subsidy Re-estimates

The total decrease in re-estimates of $2.6 million (141 percent) is related to the analysis of cash flows for direct loans. The last re-estimate of cash flow is compared with the new analysis of cash flow and any deviation from the projections will result in a change (re-estimate).

Defaulted Guarantee Loans from Post-1991 Guarantees

As of September 30, 2005, the Department had no default guaranteed loans.

Guaranteed Loans Outstanding		
As of September 30	**Outstanding Principal, Guaranteed Loans, Face Value**	**Amount of Outstanding Principal Guaranteed**
	(Amounts in millions)	
Military Housing Privatization Initiative	$551.8	$551.8
Armament Retooling & Manufacturing Support Initiative	27.0	24.2
Total	**$578.8**	**$576.0**
2005		
New Guaranteed Loans Disbursed		
Military Housing Privatization Initiative	165.0	165.0
Armament Retooling & Manufacturing Support Initiative	0.7	0.6
Total	**$165.7**	**$165.6**
2004		
Military Housing Privatization Initiative	0.0	0.0
Armament Retooling & Manufacturing Support Initiative	0.0	0.0
Total	**$0.0**	**$0.0**

The Guaranteed Loans Outstanding for the MHPI program as of the 4th Quarter, FY 2005 consists of the following:

	(in Millions)
Robins Air Force Base, Georgia	$25.6
Fort Carson, Colorado	144.9
Kirtland Air Force Base, New Mexico	74.0
Wright Patterson Air Force Base, Ohio	65.0
Elmendorf Air Force Base, Alaska	48.0
Lackland Air Force Base, Texas	29.3
Fort Polk, Louisiana (New for FY 2005)	165.0
Total Guaranteed Loans Outstanding	**$551.8**

Liability for Post-1991 Loan Guarantees, Present Value		
As of September 30	2005	2004
	(Amounts in millions)	
Loan Guarantee Program		
Military Housing Privatization Initiative	$28.7	$22.1
Armament Retooling & Manufacturing Support Initiative	12.4	12.3
Total	**$41.1**	**$34.4**

The liability for loan guarantees increased by $6.7 million (20 percent) due to one loan guarantee disbursed in FY 2005 for Fort Polk, Louisiana. For additional information, see the Schedule for Reconciling Loan Guarantee Liability Balances for Post-1991 Loan Guarantees.

Subsidy Expense for Post-1991 Loan Guarantees					
As of September 30 *(Amounts in millions)*					
2005	**Interest Differential**	**Defaults**	**Fees**	**Other**	**Total**
1. New Loan Guarantees Disbursed:					
Military Housing Privatization Initiative	0.0	10.3	0.0	0.0	10.3
Total	**$0.0**	**$10.3**	**$0.0**	**$0.0**	**$10.3**
2004					
2. New Loan Guarantees Disbursed:					
Armament Retooling & Manufacturing Support Initiative	0.0	0.2	(0.1)	0.0	0.1
Total	**$0.0**	**$0.2**	**($0.1)**	**$0.0**	**$0.1**

2005	**Modifications**	**Interest Rates**	**Technical Reestimates**	**Total Reestimates**	**Total**
3. Modifications and Reestimates:					
Military Housing Privatization Initiative	1.1	(1.5)	(3.4)	(4.9)	(3.8)
Total	**$1.1**	**($1.5)**	**($3.4)**	**($4.9)**	**($3.8)**
2004					
4. Modifications and Reestimates:					
Military Housing Privatization Initiative	1.9	0.0	(4.4)	(4.4)	(2.5)
Armament Retooling & Manufacturing Support Initiative	0.0	0.0	7.5	7.5	7.5
Total	**$1.9**	**$0.0**	**$3.1**	**$3.1**	**$5.0**

	2005	2004
5. Total Loan Guarantee:		
Military Housing Privatization Initiative	6.5	(2.5)
Armament Retooling & Manufacturing Support Initiative	0.0	7.6
Total	**$6.5**	**$5.1**

The total subsidy expense for loan guarantees increased by $1.4 million (30 percent) due to a new loan guarantee disbursed in FY 2005 for Fort Polk, Louisiana. Expense activity occurs at the point when a new loan guarantee is disbursed. There was also a modification and re-estimate of loan guarantee activity in FY 2005 due to an internal analysis performed at the end of the fiscal year.

Subsidy Rate for Loan Guarantees					
	Interest Supplements	Defaults	Fees and other Collections	Other	Total
Loan Guarantees:					
Military Housing Privatization Initiative	0.00%	9.65%	0.00%	0.00%	9.65%
Armament Retooling & Manufacturing Support Initiative	0.00%	3.75%	-1.79%	0.00%	1.96%

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

Schedule for Reconciling Loan Guarantee Liability Balances for Post-1991 Loan Guarantees		
As of September 30	2005	2004
	(Amounts in millions)	
Beginning Balance of the Loan Guarentee Liability	$34.4	$25.9
Add: Subsidy Expense for Guaranteed Loans Disbursed during the Reporting Years by Component		
Default Costs (Net of Recoveries)	10.3	0.2
Fees and Other Collections	0.0	(0.1)
Total of the above Subsidy Expense Components	**10.3**	**0.1**
Adjustments		
Fees Received	0.1	0.0
Interest Accumulation on the Liability Balance	1.1	5.3
Total of the above Adjustments	**1.2**	**5.3**
Ending Balance of the Loan Guarantee Liability before Re-estimates	**45.9**	**31.3**

Schedule for Reconciling Loan Guarantee Liability Balances for Post-1991 Loan Guarantees		
As of September 30	2005	2004
Add or Subtract Subsidy Re-estimates by Component		
Interest Rate Re-estimate	(1.5)	0.0
Technical/default Re-estimate	(3.3)	3.1
Total of the above Re-estimate Components	**(4.8)**	**3.1**
Ending Balance of the Loan Guarantee Liability	**$41.1**	**$34.4**

Subsidy Expense

The subsidy expense components increased by $10.2 million due to one loan guarantee disbursed in FY 2005 for Fort Polk, Louisiana. This disbursement caused an increase in subsidy default costs. This disbursement was issued in the 1st Quarter, FY 2005.

Adjustments

The $4.1 million decrease in total adjustments is primarily due to the re-estimated loan amortization amount from the Treasury. The accumulation is interest revenue from the Treasury.

Subsidy Re-estimates

The subsidy re-estimates decreased by $8.0 million primarily due to the downward re-estimate of subsidy.

Administrative Expenses

Administrative Expense is limited to separately identified expenses administered to direct and guaranteed loans. DoD does not maintain a separate program to capture the expenses related to direct and guaranteed loans for the MHPI. Administrative Expense for the ARMS is a fee paid to the US Department of Agriculture Rural Business-Cooperative Service (RBS) for administering the loan guarantees under the ARMS, which is a joint program. There were no administrative expenses in FY 2005.

Note 9 - Inventory and Related Property

As of September 30	2005	2004
	(Amounts in millions)	
Inventory, Net	$79,699.1	$75,494.2
Operating Materials & Supplies, Net	141,533.6	143,489.7
Stockpile Materials, Net	1,340.6	1,521.8
Total	**$222,573.3**	**$220,505.7**

Inventory, Net					
As of September 30	2005			2004	
	(Amounts in millions)				Valuation Method
	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Inventory, Net	
Inventory Categories					
Available and Purchased for Resale	$80,033.8	($25,582.2)	$54,451.6	$49,660.8	LAC,MAC
Held for Repair	27,961.0	(3,507.0)	24,454.0	24,657.9	LAC,MAC
Excess, Obsolete, and Unserviceable	6,835.6	(6,835.6)	0.0	0.0	NRV
Raw Materials	25.8	0.0	25.8	21.3	MAC,SP,LAC
Work in Process	767.7	0.0	767.7	1,154.2	AC
Total	**$115,623.9**	**($35,924.8)**	**$79,699.1**	**$75,494.2**	
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 MAC = Moving Average Cost					

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

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

General Composition of Inventory

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

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

Fluctuations

Inventory Available and Purchased for Resale increased $4.8 billion (10 percent). The primary reason for the increase was due to a revaluation of Inventory and prior-period adjustments by the Air Force of $11.3 billion. Air Force FY 2004 Inventory was restated (increased) by $7.3 billion for accounting errors; the remaining

$4.0 billion was recorded as an adjustment and an increase to FY 2005 Inventory. Further information on this prior period adjustment is in Note 19, "Statement of Changes in Net Position."

Operating Materials and Supplies, Net					
As of September 30	2005			2004	
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	Valuation Method
	(Amounts in millions)				
OM&S Categories					
Held for Use	126,300.0	0.0	126,300.0	127,765.1	SP, LAC
Held for Repair	17,341.7	(2,108.1)	15,233.6	15,724.6	SP, LAC
Excess, Obsolete, and Unserviceable	3,664.5	(3,664.5)	0.0	0.0	NRV
Total	**$147,306.2**	**$(5,772.6)**	**$141,533.6**	**$143,489.7**	
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					

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

Stockpile Materials, Net					
As of September 30	2005			2004	
	Stockpile Materials Amount	Allowance for Gains (Losses)	Stockpile Materials, Net	Stockpile Materials, Net	Valuation Method
	(Amounts in millions)				
Stockpile Materials Categories					
Held for Sale	$1,246.5	$0.0	$1,246.5	$1,427.7	AC, LCM
Held in Reserve for Future Sale	94.1	0.0	94.1	94.1	AC, LCM
Total	**$1,340.6**	**$0.0**	**$1,340.6**	**$1,521.8**	
Legend for Valuation Methods:					
LAC = Latest Acquisition Cost NRV = Net Realizable Value SP = Standard Price			LCM = Lower of Cost or Market AC = Actual Cost O = Other		

Stockpile materials are strategic and critical materials held due to statutory requirements, for use in national defense, conservation or national emergencies. All materials held by the National Defense Stockpile are classified as Material Held in Reserve until Congressional action declares the materials are no longer required to be stockpiled, and are available for sale on the open market. When National Defense Stockpile receives authorization to offer materials for sale, National Defense Stockpile removes the materials from Material Held in Reserve and reclassifies them as Materials Held for Sale. Disposals cannot be made from the stockpile except under the following situations: (1) necessary upgrading, refining, or processing; (2) necessary rotation to prevent deterioration; (3) determination as excess with potential financial loss if retained, and (4) as authorized by law. The estimated market price of the stockpile materials held for sale is $1.6 billion.

Note 10 - General PP&E, Net

As of September 30	2005					2004
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
	(Amounts in millions)					
Major Asset Classes						
Land	N/A	N/A	$10,479.4	N/A	$10,479.4	$10,103.0
Buildings, Structures, and Facilities	S/L	20 or 40	163,929.6	(95,378.3)	68,551.3	67,983.7
Leasehold Improvements	S/L	Lease Term	308.3	(131.8)	176.5	42.8
Software	S/L	2-5 or 10	7,889.7	(4,405.4)	3,484.3	2,496.0
General Equipment	S/L	5 or 10	63,478.7	(46,896.5)	16,582.2	15,971.8
Military Equipment	S/L	Various	1,202,889.8	(862,080.0)	340,809.8	324,440.0
Assets Under Capital Lease	S/L	Lease Term	630.5	(445.5)	185.0	206.7
Construction-in-Progress	N/A	N/A	20,304.3	N/A	20,304.3	19,574.6
Other			159.3	(32.8)	126.5	80.0
Total General PP&E			**$1,470,069.6**	**$(1,009,370.3)**	**$460,699.3**	**$440,898.6**
[1] Note 15 for additional information on Capital Leases						
Legend for Valuation Methods:						
S/L = Straight Line N/A = Not Applicable						

Fluctuations

General Property, Plant and Equipment (PP&E) increased $19.8 billion (5 percent).

Assets Under Capital Lease		
As of September 30	2005	2004
	(Amounts in millions)	
Entity as Lessee, Assets Under Capital Lease		
Land and Buildings	$619.6	$574.6
Equipment	10.9	11.3
Accumulated Amortization	(445.5)	(379.2)
Total Capital Leases	**$185.0**	**$206.7**

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

Note 11 - Liabilities Not Covered by Budgetary Resources

As of September 30	2005	2004
	(Amounts in millions)	
Intragovernmental Liabilities		
Accounts Payable	$0.0	$9.2
Debt	14.3	15.0
Other	7,619.4	5,303.1
Total Intragovernmental Liabilities	7,633.7	5,327.3
Nonfederal Liabilities		
Accounts Payable	425.4	695.8
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	1,483,425.0	1,348,776.0
Environmental Liabilities	62,239.1	60,979.4
Other Liabilities	14,014.3	15,158.0
Total Nonfederal Liabilities	1,560,103.8	1,425,609.2
Total Liabilities Not Covered by Budgetary Resources	**1,567,737.5**	**1,430,936.5**
Total Liabilities Covered by Budgetary Resources	**305,625.7**	**279,177.1**
Total Liabilities	**$1,873,363.2**	**$1,710,113.6**

Liabilities Not Covered by Budgetary Resources are those liabilities which are not considered covered by realized budgetary resources as of the Balance Sheet date.

Fluctuations

Intragovernmental Accounts Payable

Intragovernmental Accounts Payable decreased $9.2 million to $0. In FY 2004, several activities recognized federal accounts payable from cancelled appropriations. These cancelled year accounts payable have now been resolved or settled.

Intragovernmental – Other

Intragovernmental Liabilities - Other increased $2.3 billion (44 percent) primarily due to the reclassification of $1.6 billion of Uncollected Custodial Liability from Liabilities Covered by Budgetary Resources to Liabilities Not Covered by Budgetary Resources as required by Treasury Guidance.

Nonfederal Accounts Payable

Nonfederal Accounts Payable decreased $270 million (39 percent) primarily due to a concentrated effort in FY 2005 to clean up unsupported accounts payable in cancelled appropriations.

Note 12 - Accounts Payable

As of September 30	2005			2004
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
	(Amounts in millions)			
Intragovernmental Payables	$2,058.0	N/A	$2,058.0	$1,888.4
Non-Federal Payables (to the Public)	28,573.9	1.5	28,575.4	28,309.0
Total	**$30,631.9**	**$1.5**	**$30,633.4**	**$30,197.4**

Note 13 - Debt

As of September 30	2005			2004
	Beginning Balance	Net Borrowings	Ending Balance	Ending Balance
	(Amounts in millions)			
Agency Debt				
Debt to the Treasury	$85.5	$0.1	$85.6	$85.5
Debt to the Federal Financing Bank	506.3	(124.8)	381.5	506.3
Total Debt	**$591.8**	**($124.7)**	**$467.1**	**$591.8**

Debt to the Federal Financing Bank

Debt owed to the Federal Financing Bank decreased $124.8 million (25 percent) primarily due to a semiannual payment of $112 million made in July 2005. As part of the Afloat Prepositioning Force program, the Department makes loan repayments to the Federal Financing Bank on behalf of ship owners in lieu of capital lease payments to ship owners. Payments are made twice a year, in January and July.

Note 14 - Environmental Liabilities and Disposal Liabilities

As of September 30	2005			2004
	Current Liability	Noncurrent Liability	Total	Total
	(Amounts in millions)			
Environmental Liabilities – Non Federal				
Accrued Environmental Restoration (DERP funded) Costs:				
Active Installations--Environmental Restoration (ER)	$1,063.6	$9,060.3	$10,123.9	$10,868.2
Active Installations--ER for Closed Ranges	44.7	7,037.3	7,082.0	7,709.0
Formerly Used Defense Sites (FUDS) -- ER	110.7	4,116.8	4,227.5	4,321.3
FUDS--ER for Transferred Ranges	69.2	14,514.8	14,584.0	14,084.3
Other Accrued Environmental Costs (Non-DERP funds)				
Active Installations--Environmental Corrective Action	29.1	594.1	623.2	569.6
Active Installations--Environmental Closure Requirements	5.9	170.6	176.5	178.5
Active Installations--Environ. Response at Active Ranges	6.5	297.6	304.1	279.6
Other	1.0	560.5	561.5	9.2
Base Realignment and Closure (BRAC)				
BRAC Installations--Environmental Restoration (ER)	335.0	2,514.2	2,849.2	3,120.9
BRAC Installations--ER for Transferring Ranges	23.2	676.1	699.3	535.9
BRAC Installations--Environmental Corrective Action	13.6	192.9	206.5	167.8
Other	123.7	219.2	342.9	209.3
Environmental Disposal for Weapons Systems Programs				
Nuclear Powered Aircraft Carriers	0.0	6,426.1	6,426.1	5,693.0
Nuclear Powered Submarines	42.4	5,794.8	5,837.2	5,188.7
Other Nuclear Powered Ships	0.0	223.9	223.9	287.5
Other National Defense Weapons Systems	2.4	195.4	197.8	271.9
Chemical Weapons Disposal Program	557.9	9,892.1	10,450.0	10,769.5
Other	54.2	57.8	112.0	103.0
Total Environmental Liabilities:	**$2,483.1**	**$62,544.5**	**$65,027.6**	**$64,367.2**

Service Component – Environmental Restoration (Cleanup) Liabilities and Environmental Disposal Liabilities	Army	Navy	Air Force	ODO	Total
	(Amounts in millions)				
Environmental Liabilities-Nonfederal					
Accrued Environmental Restoration (Defense Environmental Restoration Program (DERP) funded) Costs:					
Active Installations-Environmental Restoration (ER)	$3,212.0	$2,666.5	$4,006.6	$238.8	$10,123.9
Active Installations--ER for Closed Ranges	5,182.7	554.5	1,344.8		7,082.0
Formerly Used Defense Sites (FUDS) –ER	4,227.4				4,227.4
FUDS--ER for Transferred Ranges	14,584.0				14,584.0
Other Accrued Environmental Costs (Non-DERP funds)					
Active Installations--Environmental Corrective Action	379.6		138.4	105.2	623.2
Active Installations--Environmental Closure Requirements	96.8		51.7	28.0	176.5
Active Installations--Environ. Response at Active Ranges	304.1				304.1
Other	529.6			31.9	561.5
Base Realignment and Closure (BRAC)					
BRAC Installations--Environmental Restoration (ER)	523.4	1,079.3	1,201.4	45.1	2,849.2
BRAC Installations--ER for Transferring Ranges	634.1	65.2			699.3
BRAC Installations--Environmental Corrective Action	54.1		152.4		206.5
Other	112.1		230.8		342.9
Environmental Disposal for Weapon Systems Programs					
Nuclear Powered Aircraft Carriers		6,426.1			6,426.1
Nuclear Powered Submarines		5,837.2			5,837.2
Other Nuclear Powered Ships		223.9			223.9
Other National Defense Weapon Systems		197.8			197.8
Chemical Weapons Disposal Program	10,450.0				10,450.0
Other				112.0	112.0
Total Nonfederal Environmental Liabilities:	**$40,290.0**	**$17,050.5**	**$7,126.1**	**$561.0**	**$65,027.6**

Others Category Disclosure Comparative Table

	September 30, 2005 ($ in Millions)
Other Accrued Environmental Costs (Non-DERP funds) – Other	
U.S. Army Corps of Engineers Formally Utilized Sites Remedial Action Program	$529.6
Defense Commissary Agency estimate includes costs associated with asbestos and lead paint contamination.	$31.9
Total	**$561.5**
Base Realignment and Closure (BRAC) – Other	
Army's BRAC unliquidated obligations that cannot be identified to a specific program/project.	$112.1
Air Force's BRAC unliquidated obligations that cannot be identified to a specific program/project.	$230.8
Total	**$342.9**
Environmental Disposal for Weapons Systems Programs – Other	
National Defense Stockpile–Other Defense Organizations (ODO)	$54.2
ODO's Environmental Disposal unliquidated obligations that cannot be identified to a specific program/project.	$57.8
Total	**$112.0**

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

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

The DoD has clean up requirements for the Defense Environmental Restoration Program (DERP) sites at active installations, BRAC installations, Formerly Used Defense Sites (FUDS), non-DERP sites at active installations, weapon systems programs, and chemical weapons disposal programs. The DoD follows the Comprehensive Environmental Response, Compensation Liability Act (CERCLA) and the Superfund

Amendment and Reauthorization Act (SARA) to clean up DERP-eligible contamination. Non-DERP eligible contamination clean up is performed in accordance with the Resource Conservation and Recovery Act (RCRA). The CERCLA and RCRA require DoD to clean up contamination in coordination with regulatory agencies, current property owners of property damaged by the Department, and third parties that have a partial responsibility for the environmental restoration. Failure to comply with agreements and legal mandates can put DoD at risk of incurring fines and penalties.

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

The Chemical Weapons Disposal Program is based on the FY 1986 National Defense Authorization Act (PL 99-145, as amended by subsequent acts) that directed the DoD to destroy the unitary chemical stockpile by April 29, 2004. The current guidelines for destruction are based on the Chemical Weapons Convention treaty. The United States ratified the treaty in April 1997 that required the stockpile of chemical weapons to be destroyed by April 2007, according to the terms outlined. The Army, as Executive Agent within the DoD, provides policy, direction, and oversight for both the Chemical Stockpile Program and the Non-Stockpile Chemical Materiel Project. As such, the Army is responsible for the safe and economical disposal of the U.S. stockpile of lethal and incapacitating chemical warfare agents and munitions.

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

The DoD has not identified any unrecognized portion of the estimated total clean up cost associated with General PP&E. The Department requires the unrecognized clean up cost associated with General PP&E to be disclosed and is working with the Military Departments to ensure this policy is properly implemented.

The Department had changes in estimates resulting from overlooked or previously unknown contaminants, better site characterization with sampling, re-estimation based on different assumptions, and lessons-learned. Environmental liabilities can also change in the future due to changes in laws and regulation, changes in agreements with regulatory agencies, and advances in technology.

The Department is working on processes to disclose: the amount of operating and capital resources disbursed to remediate legacy waste; the unrecognized portion of the estimated costs associated with General PP&E; and changes in estimates due to laws and technology.

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

Note 15 - Other Liabilities

As of September 30	2005			2004
	Current Liability	Noncurrent Liability	Total	Total
	(Amounts in millions)			
Intragovernmental				
Advances from Others	$394.6	$0.0	$394.6	$749.6
Deposit Funds and Suspense Account Liabilities	742.1	0.0	742.1	561.6
Disbursing Officer Cash	2,092.0	0.0	2,092.0	2,071.8
Judgment Fund Liabilities	162.6	0.0	162.6	379.8
FECA Reimbursement to the Department of Labor	588.9	806.5	1,395.4	1,432.2
Other Liabilities	4,707.4	1,656.7	6,364.1	5,531.9
Total Intragovernmental Other Liabilities	8,687.6	2,463.2	11,150.8	10,726.9
Nonfederal				
Accrued Funded Payroll and Benefits	7,382.8	0.0	7,382.8	10,871.8
Advances from Others	1,697.5	0.0	1,697.5	1,741.6
Deferred Credits	11.8	0.0	11.8	4.2
Deposit Funds and Suspense Accounts	413.9	0.0	413.9	322.6
Temporary Early Retirement Authority	0.4	0.3	0.7	2.1
Nonenvironmental Disposal Liabilities				
Military Equipment (Nonnuclear)	18.5	665.0	683.5	565.8
Excess/Obsolete Structures	53.8	182.1	235.9	435.3
Conventional Munitions Disposal	0.0	1,318.4	1,318.4	1,325.9
Accrued Unfunded Annual Leave	8,566.1	0.0	8,566.1	7,991.5
Capital Lease Liability	184.6	132.6	317.2	299.9
Other Liabilities	8,526.2	831.4	9,357.6	10,930.5
Total Nonfederal Other Liabilities	26,855.6	3,129.8	29,985.4	34,491.2
Total Other Liabilities	**$35,543.2**	**$5,593.0**	**$41,136.2**	**$45,218.1**

Nonfederal Other Liabilities – Fluctuations

Nonfederal Other Liabilities decreased $4.5 billion (13%) primarily due to changes in Accrued Funded Payroll and Benefit, Other Liabilities, and Accrued Unfunded Annual Leave.

The Accrued Funded Payroll and Benefit decreased $3.5 billion primarily due to the reclassification of Incurred But Not Reported Costs to Other Accrued Liabilities and decreased accrual for military pay. In FY 2004, the liability reflected an accrual of one-half month of military payroll. Since military pay disbursements were paid on September 30, 2005, no additional accruals were necessary in FY 2005.

The Other Liabilities, comprised of Contingent Liabilities, Custodial Liabilities, Other Accrued Liabilities, and Other Liabilities, decreased $1.6 billion.

- Contingent Liabilities decreased $2.3 billion due to a change in the accounting methodology used for items held for repair (reparable carcasses) and a reclassification of chemical demilitarization contingent liabilities as Environmental Liabilities.

- Custodial liabilities decreased by $1.7 billion for foreign military sales primarily due to the transfer of Japanese funds from the Foreign Military Sales Trust Fund to the Federal Financing Bank.

- The Other Accrued Liabilities increased $2.3 billion primarily due to increased Incurred But Not Reported Costs for TRICARE Management Activity and the Medicare-Eligible Retiree Health Care Fund, and the reclassification of these costs as Other Accrued Liabilities. The increased cost is due to changes in the methodology used to estimate these costs, including the medical rate of inflation, authorized beneficiaries, and increasing numbers of retirees taking full advantage of their benefits.

The Accrued Unfunded Annual Leave increase of $574.7 million is consistent with the fluctuation reported in previous annual statements.

Intragovernmental Other Liabilities

Intragovernmental Other Liabilities are comprised primarily of custodial liabilities resulting from accounts receivable for cancelled appropriations and interest, penalties, fines, and administrative fees from the public. The amounts collected cannot be used by DoD and must be distributed to the Department of Treasury.

Nonfederal Other Liabilities

Nonfederal Other Liabilities include employer contributions and payroll taxes payable, contingent liabilities, contract holdbacks, contract incentives, and incurred but not reported costs. Incurred but not reported costs result from medical care provided at nonfederal facilities which have not yet been billed to DoD.

Capital Lease Liability				
As of September 30	2005 - Asset Category			2004
	Land and Buildings	Equipment	Total	Total
	(Amounts in millions)			
Future Payments Due				
2006	$63.8	$0.2	$64.0	$66.4
2007	57.9	1.1	59.0	66.0
2008	47.1	4.0	51.1	61.1
2009	43.9	0.1	44.0	51.0
2010	43.9	0.0	43.9	43.9
After 5 Years	137.6	0.0	137.6	129.3
Total Future Lease Payments Due	394.2	5.4	399.6	417.7
Less: Imputed Interest Executory Costs	82.0	0.4	82.4	117.8
Net Capital Lease Liability	**$312.2**	**$5.0**	**317.2**	**299.9**
Capital Lease Liabilities Covered by Budgetary Resources			**74.1**	**219.4**
Capital Lease Liabilities Not Covered by Budgetary Resources			**$243.1**	**$80.5**

For the Department of Defense, all leases prior to FY 1992 are funded on an annual basis and subject to the availability of funds. Noncurrent amounts for these leases are shown as not covered by budgetary resources.

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

Note 16 - Commitments and Contingencies

Legal Contingencies

The Department is a party in various administrative proceedings and legal actions, with claims including environmental damage claims, equal opportunity matters, and contractual bid protests. The Department has accrued contingent liabilities for legal actions where the Department's 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 Department records Judgment Fund liabilities in Note 15, "Other Liabilities" and Note 12 "Accounts Payable." See Notes 15 and 12 for details.

The Department's General Counsel reported 42 legal actions with individual claims greater than the DoD-wide materiality threshold of $171.4 million for fiscal year 2005. The total claim amount of these 42 actions is approximately $342 billion. The Department's General Counsel identified 35 of these cases ($331 billion) as unable to determine the outcome.

Other Commitments and Contingencies

The Department also has a number of potential claims that individually do not meet the $171.4 million threshold materiality at the DoD-wide level, but do meet individual DoD Component level thresholds. These claims should be disclosed in the Component's financial statements.

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

As of September 30	2005				2004
	Actuarial Present Value of Projected Plan Benefits	Assume Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Actuarial Liability	Unfunded Actuarial Liability
	(Amounts in millions)				
Pension and Health Benefits					
Military Retirement Pensions	$892,111.6	$6	($191,138.9)	$700,972.7	$653,449.0
Military Retirement Health Benefits	296,473.2	6.25	0.0	296,473.2	221,242.0
Medicare-Eligible Retiree Benefits	537,397.0	6.25	(59,816.0)	477,581.0	465,987.9
Total Pension and Health Benefits	1,725,981.8		(250,954.9)	1,475,026.9	1,340,678.9
Other					
FECA	6,918.9	5.02	0.0	6,918.9	6,958.7
Voluntary Separation Incentive Programs	1,495.7		(649.6)	846.1	892.0
DoD Education Benefits Fund	1,661.4		(1,028.4)	633.0	246.4
Total Other	10,076.0		(1,678.0)	8,398.0	8,097.1
Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities:	**$1,736,057.8**		**($252,632.9)**	**$1,483,424.9**	**$1,348,776.0**
Actuarial Cost Method Used: Aggregate entry-age normal method Assumptions: See Below Market Value of Investments in Market-based and Marketable Securities: $262.2 billion					

Fluctuations

The unfunded liability for Military Retirement and Other Employment-Related Actuarial Liabilities increased $124.7 billion (9 percent) and is attributable to an increase of $156.4 billion (10 percent) in the actuarial liability that was partially offset by an increase of $31.7 billion in the value of assets available to pay benefits.

Military Retirement Benefits

The unfunded actuarial liability increased $47.5 billion (7 percent). This increase is attributable to an increase of $57.5 billion in the actuarial liability that is offset by an increase of $10.0 billion in the value of assets available to pay benefits. The increase in the actuarial liability is primarily the result of an amendment to the Military Retirement Fund (MRF) Plan established by the National Defense Authorization Act for FY 2005 increasing survivor benefits.

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

The long-term economic assumptions for each valuation are set by the DoD Retirement Board of Actuaries. The long-term assumptions for the FY 2004 valuation were 6.25 percent interest, 3.0 percent Consumer Price Index, and 3.75 percent salary increase. The long-term economic assumptions did not change for the FY 2005 valuation. Other assumptions used to calculate the actuarial liabilities, such as mortality and retirement rates, were based on actual experience. Because of reporting deadlines, the current year actuarial present value of projected plan benefits is rolled forward, using accepted actuarial methods, from the prior year valuation results as reported in the DoD Office of Actuary Valuation of the Military Retirement System. In calculating the FY 2005 roll-forward amount, the following assumptions were used:

	Inflation	Salary	Interest
Fiscal Year 2005	2.7 percent (actual)	3.5 percent (actual)	6.25 percent
Fiscal Year 2006	4.1 percent (actual)	3.1 percent (estimated)	6.25 percent
Long-Term	3.0 percent	3.75 percent	6.25 percent

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

Actuarial Cost Method Used: Aggregate entry-age normal method.
Market Value of Investments in Market-Based and Marketable Securities: $197.4 billion

	FY 2005 (Amounts in millions)
Actuarial Liability as of 9/30/04	$834,582.1
Expected Normal Cost for FY 05	14,857.2
Plan Amendment Liability	25,835.9
Assumption Change Liability	4,904.2
Expected Benefit Payments for FY 05	(38,704.4)
Interest Cost for FY 05	51,427.4
Actuarial (gains)/losses due to changes in trend assumptions	(709.9)
Actuarial Liability as of 09/30/05	$892,111.6
Change in Actuarial Liability	**$57,529.5**

Military Retirement Health Benefits (MRHB)

The unfunded actuarial liability for the Military Retirement Health Benefits increased $75.2 billion (34 percent). In FY 2005, there was a significant actuarial loss attributable to medical cost experience; this loss is included in "Actuarial (gains)/losses due to other factors" in the table above. Other (gains)/losses in this line include new population data, other actuarial experience being different from assumed and actuarial assumption changes other than the change in trend assumptions.

Change in MRHB Actuarial Liability

	(Amounts in millions)
Actuarial Liability as of 09/30/04 (DoD pre-Medicare + all Uniformed Services medicare cost-basis effect)	$221,242.0
Expected Normal Cost for FY05	7,686.0
Expected Benefit Payments for FY05	(7,718.0)
Interest Cost for FY05	13,827.0
Actuarial (gains)/losses due to other factors	20,323.0
Actuarial (gains)/losses due to changes in trend assumptions	41,113.0
Actuarial Liability as of 09/30/05 (DoD pre-Medicare + all Uniformed Services medicare cost-basis effect)	*$296,473.0
Change in Actuarial Liability	**$75,231.0**

* MRHB Actuarial Liability is comprised of the following components not previously seperately identified:

Tricare Management Activity Actuarial Liability as of 9/30/05	$155,155.0
Service Management Activity Actuarial Liability as of 9/30/05	141,318.0
Total MRHB Actuarial Liability	***$296,473.0**

Assumptions in Calculation of MRHB Liability
Interest Rate: 6.25%

Medical Trend

Medicare Inpatient:	3.2% from FY04 to FY05, ultimate rate of 6.25% in 2029.
Medicare Outpatient:	5.6% from FY04 to FY05, ultimate rate of 6.25% in 2029.
Medicare Prescriptions (Direct Care):	10.0% from FY04 to FY05, ultimate rate of 6.25% in 2029.
Medicare Prescriptions (Purchased Care):	15.2% from FY04 to FY05, ultimate rate of 6.25% in 2029.
Non-Medicare Inpatient:	6.1% from FY04 to FY05, ultimate rate of 6.25% in 2029.
Non-Medicare Outpatient:	6.25% from FY04 to FY05, ultimate rate of 6.25% in 2029.
Non-Medicare Prescription:	15.1% from FY04 to FY05, ultimate rate of 6.25% in 2029.

Other Information

The DHP liability includes pre-Medicare liabilities for the Department of Defense, plus a cost-basis effect related to the direct care portion of Medicare liabilities for all Uniformed Services. The approximate breakout of the September 30, 2005, liability was:

	(Amounts in millions)
DoD	$295,962.0
Coast Guard	453.0
Public Health Service	54.0
National Oceanic & Atmospheric Administration (NOAA)	4.0
Total	**$296,473.0**

Prior to the end of FY 2005, the "DHP" liability included pre-Medicare liabilities for the Department of Defense, plus a cost-basis effect related to the direct care portion of Medicare liabilities for all Uniformed Services. The cost-basis effect is approximately $22.3 billion as of September 30, 2005, and arises because liabilities for direct care in the total Military Retirement Health Benefits liability are valued at a higher cost basis than they are in the Medicare Eligible Retiree Health Care Fund (MERHCF) liability.

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

Medicare-Eligible Retiree Benefits

The MERHCF unfunded actuarial liability increased $11.6 billion (2 percent). This increase is attributable to an increase of $33.3 billion in the actuarial liability that is offset by an increase of $21.7 billion in the value of assets available to pay benefits.

Change in MERHCF Actuarial Liability

	(Amounts in millions)
Actuarial Liability as of 09/30/04 (all Uniformed Services Medicare)	$504,073.8
Expected Normal Cost for FY05	10,613.8
Expected Benefit Payments for FY05	(6,546.9)
Interest Cost for FY05	31,629.8
Actuarial (gains)/losses due to other factors	(14,902.7)
Actuarial (gains)/losses due to changes in trend assumptions	12,529.3
Actuarial Liability as of 09/30/05 (all Uniformed Services Medicare)	$537,397.2
Change in Actuarial Liability	**$33,323.3**

Assumptions in Calculation of MERHCF Liability
Interest Rate: 6.25%

Medical Trend

Medicare Inpatient:	3.2% from FY04 to FY05, ultimate rate of 6.25% in 2029.
Medicare Outpatient:	5.6% from FY04 to FY05, ultimate rate of 6.25% in 2029.
Medicare Prescriptions (Direct Care):	10.0% from FY04 to FY05, ultimate rate of 6.25% in 2029.
Medicare Prescriptions (Purchased Care):	15.2% from FY04 to FY05, ultimate rate of 6.25% in 2029.

The MERHCF liability includes Medicare liabilities for all Uniformed Services. The approximate breakout of the September 30, 2005, liability was:

	(Amounts in millions)
DoD	$526,082.5
Coast Guard	10,176.7
Public Health Service	1,067.0
NOAA	71.0
Total	**$537,397.2**

FY 2005 Service contributions to the MERHCF were:

	(Amounts in millions)
DoD	$10,220.0
Coast Guard	236.7
Public Health Service	32.1
NOAA	1.5
Total	**$10,490.3**

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

Projected revenues into the Medicare Eligible Retiree Health Care Fund, authorized by Chapter 56 of Title 10, United States Code, come from three sources: interest earnings on Fund assets, monthly Uniformed Services "normal cost" contributions, and annual contributions from the Treasury Department. The monthly contributions are determined as a per-capita amount (approved by the DoD Medicare Eligible Retiree Health Care Board of Actuaries) times end strength. The contribution from Treasury is paid into the Fund at the beginning of each fiscal year and represents the amortization of the unfunded liability for service performed prior to October 1, 2002, as well as the amortization of actuarial gains and losses that have arisen since then. The Board determines Treasury's contribution, and the Secretary of Defense directs the Secretary of Treasury to make the payment. Starting in FY 2006, the beginning-of-fiscal-year Treasury contribution will also include the total normal cost amount for the year, determined based on Board-approved per capita normal cost rates and expected average force strengths for the Uniformed Services. Thus, starting in FY 2006, the Services will no longer make monthly contributions into the Fund.

The actuarial liability reported above does not include $762.2 million in incurred but not reported liabilities as of September 30, 2005. These liabilities are disclosed in the Liabilities Not Covered and Covered by Budgetary Resources note, and the Other Liabilities note.

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

Actuarial Cost Method Used for MERHCF Liability: Aggregate Entry-Age Normal
Market Value of Investments in Market-Based and Marketable Securities: $60.0 billion

Federal Employees Compensation Act (FECA)

The unfunded liability for FECA decreased 1 percent.

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

Year 1	4.53%
Year 2	5.02%
Year 3 and thereafter	5.02%

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIMs) were applied to the calculation of projected future benefits. The actual rates for these factors for the charge back year (CBY) 2005 were also used to adjust the methodology's historical payments to current year constant dollars.

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

CBY	COLA	CPIM
2005	2.20%	4.33%
2006	3.33%	4.09%
2007	2.93%	4.01%
2008	2.40%	4.01%
2009+	2.40%	4.01%

The model's resulting projections were analyzed to insure that the estimates were reliable. The analysis was based on three tests: (1) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual payments; (2) a comparison of the ratio of the estimated liability to the actual payment of the beginning year calculated for the current projection to the liability-payment ratio calculated for the prior projection; and (3) a comparison of the incremental paid losses (the medical component in particular) in CBY 2005 (by injury cohort) to the average pattern observed during the prior three charge back years.

Voluntary Separation Incentive Programs (VSI)

The unfunded actuarial liability decreased $45.9 million (5 percent) as a result of a decrease of $97.8 million in the actuarial liability and a decrease of $51.9 million in the value of assets available to pay benefits.

The VSI program was established by Public Law 102-190. The intent of this program is to reduce the number of military personnel on active duty. This plan was offered to personnel with a minimum of six years of service who do not qualify for retirement. The incentive payments are spread over a period equivalent to twice the years of active service. The annual payment is based on 2.5 percent of the person's basic pay at the time they leave service multiplied by the number of years of service. The September 30, 2005, VSI Actuarial Present Value of Projected Plan Benefits (Actuarial Liability) was calculated at an assumed annual interest rate of 4 percent.

Since the VSI program is discontinued for new takers, each year the Actuarial Liability is expected to decrease with benefit outlays, and increase with interest cost. In the absence of (1) actuarial gains and losses, and (2) assumption changes, a decrease of $94 million in the Actuarial Liability was expected during FY 2005. The September 30, 2005, Actuarial Liability includes changes due to experience, which resulted in a net gain of $3 million. This reflects the new population on which the September 30, 2005, Actuarial Liability is based, as well as other economic experience being different than assumed.

The Present Value of Projected Plan Benefits (Actuarial Liability) for the VSI Fund, as of September 30, 2005, is $1.5 billion. It has been calculated as in prior years; namely, as the present value, as of September 30, 2005, of all remaining VSI payments.

Market Value of Investments in Market-based and Marketable Securities: $624 million.

DoD Education Benefits Fund

The estimated present value of benefit (PVB) for the Department of Defense Education Benefits Fund as of September 30, 2004, increased over what was reported on the FY 2004 statement because of a new educational benefit for mobilized reservists under Chapter 1607 of Title 10. Chapter 1607, in turn, reduced the liabilities under Chapter 1606. In addition, the PVB includes more complete experience, a different interest rate (5.1 percent vs. 5.3 percent), and somewhat different modeling. The net effect of these changes was to increase the PVB by $386 million (157 percent). For the numbers reported as of September 30, 2005, there is a further increase (net $21 million) (2 percent) due to an additional year of new entrants, the inclusion of National-Call-to-Service benefits (10USC510), and calculating the present value of benefits as of a year later.

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

Market Value of Investments in Market-based and Marketable Securities: $1.0 billion

Note 18 - Disclosures Related to the Statement of Net Cost

General Disclosures Related to the Statement of Net Cost

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

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

Fluctuations

Intragovernmental Earned Revenue
Intragovernmental Earned Revenue increased $2.8 billion (18 percent) primarily due to a $2.1 billion increase in interest on investments and increased reimbursable work performed for the Federal Emergency Management Agency (FEMA) for hurricane relief efforts.

Gross Costs With the Public
Gross Costs With the Public increased $36.0 billion (6 percent) primarily due to a $32.2 billion increase in future funded expenses related to actuarial liability estimates.

Earned Revenue From the Public
Earned Revenue From the Public increased $4.6 billion (21 percent) primarily due to a $2.3 billion increase for real property additions and inventory revaluation gains. In addition, the Army incurred a $2.0 billion increase primarily due to inventory reporting errors in the Logistics Modernization Program. This resulted in revenues and expenses being overstated in FY 2005. The Department is working to resolve the issue.

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

As of September 30	2005		2004	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
	(Amounts in millions)			
Prior Period Adjustments Increases (Decreases) to Net Position				
Changes in Accounting Standards	$3,632.4	$0.0	$699.5	$0.0
Errors and Omissions in Prior Year Accounting Reports	7,256.5	0.0	(7,257.0)	25,913.7
Other Prior Period Adjustments	0.0	0.0	(1,044.7)	0.0
Total Prior Period Adjustments	**10,888.9**	**0.0**	**(7,602.2)**	**25,913.7**
Imputed Financing				
Civilian CSRS/FERS Retirement	1,604.1	0.0	1,658.6	0.0
Civilian Health	2,457.1	0.0	2,248.7	0.0
Civilian Life Insurance	24.7	0.0	22.4	0.0
Judgment Fund	379.4	0.0	162.8	0.0
Intra-Entity	0.0	0.0	0.0	0.0
Total Imputed Financing	**$4,465.3**	**$0.0**	**$4,092.5**	**$0.0**

Prior Period Adjustments

The Department of Defense recorded $10.9 billion (net) in prior period adjustments to Cumulative Results of Operations. In FY 2005, the Air Force completed conversion of its inventory valuation method from Latest

Acquisition Cost to Moving Average Cost. This resulted in adjustments to eliminate allowance for gains and losses, establish an allowance for repair and revalue the inventory. Total inventory revaluation was $11.3 billion. The revaluation was offset by the $0.4 billion reversal of erroneous gains and losses from prior years.

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

Imputed Financing

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

Fluctuations

Cumulative Results of Operations

Budgetary Financing Sources, Transfers-in/out Without Reimbursement decreased $7.4 billion primarily due to the Department receiving less budgetary resources for the Iraqi Relief and Reconstruction Fund. The Department reported $2.9 billion in FY 2005 and $10.3 billion in FY 2004.

Other Budgetary Financing Sources, Other decreased $4.5 billion due to a correction in the treatment of reconciling adjustments. Due to system deficiencies, the Department is unable to fully reconcile budgetary and proprietary trial balances and must make reconciling adjustments. Prior to FY 2005, these adjustments were being reflected incorrectly on this line. These adjustments are now correctly reflected as Other Financing Sources, Other.

Other Financing Sources, Transfers-in/out Without Reimbursement (net transfers) decreased by $2.8 billion. In FY 2004, the Department transferred-in a large actuarial liability from the U.S. Coast Guard to the Medicare Eligible Retiree Health Care Fund. Net transfers in FY 2005 consist of a downward subsidy reestimate on loan guarantees for Military Housing Privatization and property transfers.

Other Financing Sources, Other decreased $2.2 billion due to the reclassification of budgetary/proprietary adjustments from Other Budgetary Financing Sources, Other discussed above.

Unexpended Appropriations

The $12.8 billion increase in appropriations received resulted primarily from:

- An increase of approximately $24.8 billion in appropriations received in the FY 2005 Appropriations Act.
- A net decrease in supplemental appropriations received of $13.4 billion in FY 2005 as compared to FY 2004.

During FY 2005, the Department received supplementals totaling $77.8 billion in support of the Global War on Terror, tsunami relief, and hurricane relief. During FY 2004, the Department received two supplementals totaling $91.2 billion.

Other Disclosures

There is a difference of $80 billion between Appropriations Received that are reported on the Statement of Changes in Net Position ($524.9 billion) and Appropriations Received in the Statement of Budgetary Resources ($604.9 billion). Trust Funds are duplicated in the Statement of Budgetary Resources but not in the Statement of Changes in Net Position. See Note 20, "Statement of Budgetary Resources," for further disclosures.

Note 20 -Disclosures Related to the Statement of Budgetary Resources

As of September 30	2005	2004
	(Amounts in millions)	
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$275,627.9	$233,505.4
Available Borrowing and Contract Authority at the End of the Period	28,006.3	25,314.3

The Net Amount of Budgetary Resources Obligated for Undelivered Orders increased $42.1 billion (18 percent). The increase is due to increased support of contingency missions Operations Enduring Freedom, Iraqi Freedom, and Noble Eagle, appropriations received for the Global War on Terror, Tsunami and Hurricane Relief, and replacement of lost, damaged, and destroyed military equipment.

Available Borrowing and Contract Authority at the end of the period increased $2.7 billion (11 percent). This fluctuation was primarily attributable to increased activity in support of the following contingency missions: Operations Enduring Freedom, Iraqi Freedom, and Noble Eagle, as well as to the increased authority available to incur obligations for Foreign Military Sales administrative expenses.

The Budgetary Financing, Budgetary Resources Section of the Statement of Budgetary Resources (SBR) reflects a decrease of $168.6 billion (17 percent). The decrease is primarily attributed to a reporting change in unobligated fund balances for special and trust funds, such as the Medicare-Eligible Retiree Health Care Fund (MERHCF) and the Military Retirement Fund (MRF). Brought forward balances from Fiscal Year 2004 were decreased by $220.7 billion to correct an inconsistency in presentation with the President's Budget. The overall decrease was partially offset by increased funding provided in support of contingency missions Operations Enduring Freedom, Iraqi Freedom, Noble Eagle, the Global War on Terror, and Tsunami and Hurricane Relief.

The Nonbudgetary Financing, Budgetary Resources Section of the SBR reflects an increase of $29.1 million (13 percent). This section of the SBR reports activity for the Military Housing Privatization Initiative. This fluctuation was primarily due to an increased number of direct loan contracts that were scheduled to be disbursed in FY 2005; however, the contracts are now scheduled for completion and disbursement in FY 2006.

The Navy incorrectly reported an appropriation transfer of $25.2 million as Appropriations Received, resulting in an overstatement of Appropriations Received.

Permanent Indefinite Appropriations

The Department of Defense received the following permanent indefinite appropriations:

- Department of the Army General Gift Fund (10 USC 2601(b)(1))
- Department of the Navy General Gift Fund (10 USC 2601(b)(2))
- Department of the Air Force General Gift Fund (10 USC 2601 (b)(3))
- Foreign National Employees Separation Pay Account, Defense (10 USC 1581)
- United States Naval Academy Gift and Museum Fund (10 USC 6973-4)
- Ship Stores Profits, Navy (10 USC 7220, 31 USC 1321)
- Midshipmen's Store (10 USC 6971B)
- Burdensharing Contributions Account (10 USC 2350j)
- Forest Program (10 USC 2665)
- Department of Defense Base Closure Account (BRAC 10 USC 2687 note)
- Medicare Eligible Retiree Health Care Fund (10 USC 1111)
- Military Retirement Fund (10 USC 1461)
- Education Benefits Fund (10 USC 2006)
- Reserve Mobilization Income Insurance Fund (RII) (10 USC 12528)
- Host Nation Support for U.S. Relocation Activities (10 USC 2350k)
- National Defense Sealift Fund (10 USC 2218)
- Environmental Restoration, Navy (10 USC 2702)
- Hydraulic Mining Debris Reservoir (33 USC 683)
- Maintenance and Operation of Dams and Other Improvements of Navigable Waters (16 USC 810(a))
- Payments to States (33 USC 701c-3)
- Wildlife Conservation (16 USC 670-670f)
- Ainsworth Bequest (IAW 31 USC 1321)

Reconciliation Differences

The Department of the Treasury issues annual warrants to pay amortized payments for the unfunded actuarial liabilities of the MRF and MERHCF. This amount is credited and expended from the Other Defense Organizations – General Funds to the MRF and MERHCF in accordance with the Office of Management and Budget (OMB) guidance. The OMB is aware of and approves of this duplicate reporting. As a result, $38.6 billion is duplicated in Appropriations Received on the SBR.

The MERHCF, MRF, Education Benefits and Voluntary Separation Incentive Program report Appropriations Received for contributions paid by the Army, Navy, and Air Force. These Military Departments also include these amounts in Appropriations Received. As a result, $25.4 billion is duplicated on the SBR.

There is a difference of $25.0 billion between undelivered orders (UDOs) reported on line 1 in the table above ($275.6 billion) and the amount of UDOs on the SBR ($250.6 billion). This difference is primarily attributable to the process of reporting UDOs with advances. Line 1 reports UDOs with advances, but the SBR does not. In addition, the SBR reports transferred obligations for UDOs without advances, but line 1 in the table above does not.

Intra-Entity Transactions

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

Direct Obligations - Apportionment Categories				
Reporting Entity	Category A	Category B	Exempt from Apportionment	Totals
	(Amounts in millions)			
Army General Fund	$174,140.9	$945.3		$175,086.2
Navy General Fund - see disclosure below	85,776.8	51,917.6		137,694.4
Air Force General Fund	70,014.7	54,673.4	1.3	124,689.4
US Army Corps of Engineers	5,710.5		29.0	5,739.5
Military Retirement Fund	39,166.2			39,166.2
Medicare-Eligible Retiree Health Care Fund	6,398.7			6,398.7
Other Defense Organizations – General Fund	110,700.4	649.2	466.0	111,815.6
Other Defense Organizations – Working Capital Fund	1,142.0			1,142.0
Totals	**$493,050.2**	**$108,185.5**	**$496.3**	**$601,732.0**

Reimbursable Obligations - Apportionment Categories				
Reporting Entity	Category A	Category B	Exempt from Apportionment	Totals
	(Amounts in millions)			
Army General Fund	$20,206.7	$4,300.0		$24,506.7
Navy General Fund - see disclosure below		13,463.8		13,463.8
Air Force General Fund	8,543.7	3,904.9		12,448.6
Army Working Capital Fund		11,850.8	4,971.6	16,822.4
Navy Working Capital Fund		23,936.0		23,936.0
Air Force Working Capital Fund		15,892.1		15,892.1
US Army Corps of Engineers	6,901.4		1.0	6,902.4
Other Defense Organizations – General Fund	5,447.4			5,447.4
Other Defense Organizations – Working Capital Fund	56,563.7			56,563.7
Totals	**$97,662.9**	**$73,347.6**	**$4,972.6**	**$175,983.1**

Due to system limitations, the Navy General Fund could not categorize obligations. Therefore, all of Navy's direct and reimbursable obligations are reported in the above table as Category "A."

NOTE:
1. Category "A" relates to appropriations for a specific period of time (e.g., Military Personnel appropriation).
2. Category "B" relates to appropriations for a specific project (e.g., Military Construction appropriation).

Note 21 - Disclosures Related to the Statement of Financing

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

Resources That Finance the Acquisition of Assets	$11,095.5 million
Other Components Not Requiring or Generating Resources	$283.1 million
Statement of Net Cost*	$.3 million

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

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

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

Resources Used to Finance Activities

Offsetting Receipts increased $8.5 billion due primarily to increases in contributions to the Military Retirement Fund and the Medicare-Eligible Retiree Health Care Fund.

Transfers In/Out Without Reimbursement decreased $2.8 billion due primarily to the reduction of transfers in from other federal agencies. In FY 2004, the U.S. Coast Guard transferred $2.8 billion to the Medicare-Eligible Retiree Health Care Fund, which completed the U.S. Coast Guard liability transfer. There were no Coast Guard transfers in FY 2005.

Other Resources – Other decreased $2.1 billion primarily due to Component adjustments to gains and losses necessary to reconcile the proprietary and budgetary accounts and adjustments to reconcile trading partner differences.

Resources Used to Finance Items not Part of the Net Cost of Operations

Resources That Finance the Acquisition of Assets increased $25.8 billion due primarily to a revision of military equipment projections provided by the Bureau of Economic Analysis (BEA), Department of Commerce. For further disclosure on military equipment see Note 10.

Components of the Net Cost of Operations Requiring or Generating Resources in the Future Periods

Increase in Environmental and Disposal Liability reported decreased $2.8 billion (72%) due to the reduction of environmental liabilities related to closed ranges. For further disclosure on environmental liabilities see Note 14.

Components Requiring Resources in Future Periods - Other consists of unfunded expenses relating to contingent liabilities, actuarial and other unfunded employment-related liabilities. The $29.0 billion increase resulted primarily from changes in actuarial liabilities for the Military Retirement Fund, Medicare-Eligible Retiree Health Care Fund and the Defense Health Program. For further disclosure on actuarial liabilities see Note 17.

Components not Requiring or Generating Resources

Depreciation and amortization increased $6.7 billion due primarily to the revision of military equipment projections provided by the BEA, Department of Commerce.

Revaluation of Assets or Liabilities increased $7.5 billion primarily due to the gains reported by the Air Force after converting their inventory valuation method from Latest Acquisition Cost to Moving Average Cost.

Note 22 - Disclosures Related to the Statement of Custodial Activity

The Statement of Custodial Activity displays current year collections and disbursements for three custodial accounts: Foreign Military Sales, Development Fund for Iraq, and Seized Assets. Funds held in a custodial activity are only used for the stated purposes and are not available for the Department's use.

Foreign Military Sales (FMS)

Current year Deposits by Foreign Governments into the FMS Trust Fund are $10.7 billion and disbursements on Behalf of Foreign Governments and International Organizations equal $11.1 billion.

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

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

Development Fund for Iraq (DFI)

The DFI is for urgent humanitarian assistance, reconstruction, and other projects carried out for the benefit of the Iraqi people. Current year deposits from the Interim Iraqi Government transferred to the Multi-National Force-Iraq are $136.0 million with $82.6 million in disbursements.

(Amounts in millions)

	During FY 2005	Cumulative from Inception
Source of Collections		
Deposits By Foreign Governments	$136.0	$136.0
Disposition of Collections		
Security and Law Enforcement	.8	.8
Electric Sector	24.4	24.4
Oil Infrastructure	.4	.4
Water Resources and Sanitation	6.7	6.7
Transportation and Telecommunications	5.2	5.2
Roads, Bridges and Construction	4.2	4.2
Health Care	2.7	2.7
Private Sector Development	3.8	3.8
Education, Refugees, Human Rights, and Governance	34.4	34.4
Total Disbursed on Behalf of Foreign Governments	82.6	82.6
Retained for Future Support of Foreign Governments (note)	53.4	53.4
Total Disposition of Collections	**$136.0**	**$136.0**
Net Custodial Collection Activity	**$0**	**$0**

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

Seized Assets

During Operation Iraqi Freedom, the U.S. Government seized assets from the former Iraqi Government that are used in support of the Iraqi people. As of September 30, 2005, $61.4 million of seized monetary assets remain to be disbursed in support of the Iraqi people as shown in the table below.

(Amount in millions)

	During FY 2005	Cumulative from Inception
Source of Collections		
Seized Iraqi Cash	$0.0	$927.2
Disposition of Collections		
Iraqi Salaries	0.0	30.8
Repair/Reconstruction/Humanitarian Assistance	51.2	495.0
Iraqi Ministry Operations (Ministry of Finance, Defense, etc.)	.8	264.7
Fuel/Supplies	0	75.3
Total Disbursed on behalf of Iraqi People	52.0	865.8
Retained for Future Support of the Iraqi People	(52.0)	61.4
Total Disposition of Collections	**$0**	**$927.2**
Net Custodial Collection Activity	**$0**	**$0**

Note 23 - Other Disclosures

As of September 30	2005			
	Land and Buildings	Equipment	Other	Total
	(Amounts in millions)			
ENTITY AS LESSEE-Operating Leases				
Future Payments Due (Fiscal Year)				
2006	$198.8	$0.2	$133.3	$ 332.3
2007	195.4	0.0	136.0	331.4
2008	216.2	0.0	138.7	354.9
2009	230.7	0.0	141.4	372.1
2010	231.2	0.0	144.3	375.5
After 5 Years	206.9	0.0	147.2	354.1
Total Future Lease Payments Due	**$1,279.2**	**$0.2**	**$ 840.9**	**$2,120.3**